MODERN BUSINESS PRACTICE

MODERN
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WORK

From the Painting by Ford Madox Brown in the Manchester Art Gallery

MODERN BUSINESS PRACTICE

A COMPREHENSIVE PRACTICAL GUIDE AND WORK OF REFERENCE FOR OFFICE WAREHOUSE EXCHANGE AND MARKET

Prepared by many Specialists under the Editorship of

F. W. RAFFETY

Barrister-at-Law

VOLUME VII

LONDON

THE GRESHAM PUBLISHING COMPANY

34 AND 35 SOUTHAMPTON STREET STRAND W.C.

MCMXIII

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FOREWORD

HOW TO SUCCEED IN BUSINESS

By the late Sir GEORGE WHITE M.P. (of Norwich)

Are the business openings in the country fewer than formerly? In my opinion the opportunities for commercial success were never so great. The young man of to-day is far better off here than in many countries on the Continent, especially compared with Germany. In the latter country his career is determined for him years before his education is finished, without reference to his inclinations and capacity. In the professions promotion is very slow and badly remunerated, so that I do not think the German young man in any way superior in business to our own people.

But, on the other hand, we are becoming very much alive to the importance of training in business. In most of our large towns facilities are now given for self-improvement as never before, in connection with technical schools and continuation classes. So that success to-day depends very largely on how our business young men utilize these advantages. It is, I often think, a matter of how they employ their leisure time, whether they fritter it away, or spend it in acquiring additional knowledge. If in the latter way, success comes quicker. Above all, there must be the keenness to seize opportunities as they come along.

In my own factory I always endeavour to impress upon young lads the necessity of doing something to improve their position. In some cases I arrange for them to get off earlier in the day to attend classes, and this endeavour to better their position is not infrequently crowned with success. Too often in our large businesses the tendency, I am afraid, is for employees to consider they should do only what they are paid for instead of really doing their utmost and qualifying for better positions. The greatest thing that determines success is a capacity for doing one's best in whatever position one is placed. We may feel sometimes that our work does not get the reward it deserves, and chafe under the want of recognition; but if we have the determination to serve as we would wish to be served, and do our best to bring about the success of whatever concern has our thought, we are bound ultimately to make a position of

more importance. Workers should be ready to seize the opportunity which presents itself, because in whatever position you are there is always room for someone who can do a little better than someone else. However selfish an employer may be, in his own interest, if he is a man of the world and a man of judgment, he is bound to recognize that it is to his advantage as well as yours that your work should be sooner or later recognized.

In business nothing comes amiss in the way of acquired knowledge. For example, how few of our business men have gone to the trouble of learning foreign languages. Nowadays it is very important to know at least French and German, yet how many firms we find engaging foreigners to conduct their foreign business because our men have not used their opportunities to fit themselves for these positions.

It is often objected that to-day the multiplication of shops owned by one firm acts detrimentally to the prospects of the small tradesman. What I think is that such shops find positions for our young business men which are practically equal to if not better than what they would have in small shops of which they were masters themselves. Of course, I quite recognize that the small proprietor is likely to take more interest in his own shop than another person's, and try to work up a sound business by his own industry and prudence. On the other side of the picture, the multiplication of large businesses finds lucrative situations for managers and foremen, that would not otherwise be open to them if the business they were in was a small one.

I always feel that there is a good position for anyone to-day who can do something better than anyone else. What I mean is that for the man who tries to do more than his bare duty there is success awaiting. He may be in an office or factory with a great many more men, all of equal ability. All may perform their allotted tasks with satisfaction, but to that man who can do a bit better what the others are doing there is always a steady and prosperous future. What tells is character, a qualification absolutely indispensable in business to-day, in spite of what is said to the contrary. There is nothing more calculated to lead to success than starting off in life with a clean sheet in regard to character.

I am not one of those who believe we as a country are being ousted by other nations. I think that if we place within easy reach of our young people opportunities for self-improvement, and these opportunities are fairly used, there is no fear of our not holding our own. The conditions here are, in my judgment, still better than in other countries. These conditions develop physical energy and bring power which, if cultivated properly, will enable us to compete on equal terms. In many of our most important branches of industry we are ahead of most other countries, although their educational advantages are being very largely used. If in anything, we suffer from too close attention to recreations. I am a firm believer in all healthy outdoor occupations, but these should not be carried to the excess sometimes observable. This, in my opinion, is the only weak spot in our armour, and unless we are disposed to limit our recreations to some extent, our foreign competitors might one day overtake us in the realm of commerce.

With regard to the relationship between employer and employee, I believe that, though this is not of the same nature as in days gone by, the position to-day is one of greater justice and equality, and is likely still to improve if the workers will continue to give the best that is in them to the work in which they are engaged.

Success in any business depends largely upon the man in it having a definite purpose. We have too many purposeless workers. Aim at something tangible and definite, and employ your whole energies to reach it, always keeping a clean record. To have recourse to dubious methods, even if they look promising for a time, always spells failure in the end. But with hard work and straightforward dealing a man will eventually "get there", as the saying is. And in my opinion there never was a time when the opportunities in business were so promising.

PART VI

SHIPPING

(Continued)

CHAPTER II

OWNERSHIP

Introductory—Registration—Transfer of a Ship—Mortgages—Name and Nationality—Measurement and Tonnage—Maritime Lien—The Employment of the Ship—Ship's Agents—Forms.

INTRODUCTORY

Ships are a very special class of property. Ownership of a ship does not pass by delivery, and the purchaser of a foreign ship may find himself subject to foreign law. Under British law ships are personal property. Property is acquired either by construction, purchase, or capture as lawful prize. By payment of instalments ownership may vest in the employer during construction, and the terms of the building contract will provide for this. Builders have a possessory lien on the ship for payments due to them. In the absence of agreement before registration ownership is presumed to be in the builder. Construction has been already dealt with in Chapter I of this Part. The circumstances under which a ship may become prize is part of international law. Capture can only take place during war, and for an effective transfer the ship must subsequently be condemned as a prize by a competent Court in a port of the belligerent State. (See Part III, Chapter XXVII.)

The conditions under which property may pass by purchase is dealt with later on. The Merchant Shipping Act, 1894, the longest of all the statutes of the realm, is divided into fourteen parts, which deal with the various aspects of shipping, and is referred to in this and other chapters as "the Act". There are also amending Acts and Regulations made under the Acts.

The owners of a British ship are usually part owners, as tenants in common, not partners, although there may be joint ownership in a particular share or shares.

The employment of the ship is decided upon by a majority of the owners, but if a minority dissent their interests are protected. They are saved from any liability in the venture, and are entitled to a bond for the value or return of the ship. The Admiralty Court has power to settle disputes between part owners, and may direct a ship to be sold, even on the application of minority owners.

A British ship must be owned wholly by qualified persons, namely, either natural-born British subjects or those made so by naturalization or by denization, or corporate bodies with their principal place of business in the British Dominions. If an alien becomes entitled to any interest, the ship loses its certificate.

Provision is made for guardians or committees to act for persons interested in a ship who are under incapacity.

A beneficial owner, other than a mortgagee, is liable as well as the registered owner to pecuniary penalties imposed by the Acts.

REGISTRATION

Subject to certain exceptions, every British ship must be registered, or it will not be recognized as a British ship. The registry forms the record of title, and is also the record of those vessels entitled to use the British flag. Any British ship not registered may be detained; but ships not exceeding 15 tons burden, employed solely in navigation on the rivers or coasts of the

United Kingdom or within some British possession where the managing owners are resident, and ships not exceeding 30 tons burden and not having a whole or fixed deck, employed solely in fishing or trading coastwise on the shores of Newfoundland, in the Gulf of St. Lawrence, or on the bordering Canadian coasts, are exempt from registry.

Registrars are constituted at the various ports: in the United Kingdom they are the chief officers of Customs; in other places the governor, the port officer, or other official. Every registrar must keep a register book and duly make entries.

The property in the ship is divided into 64 shares, and not more than 64 owners are to be registered at the same time, though not more than five people may be registered as joint owners of a ship, and are then considered as constituting one person. A corporation may be registered as owner.

Beneficial title may exist apart from registration, but no notice of trust is entered upon the register. As between the immediate parties a trust may be enforced or protected.

Survey

Before registry, every British ship is surveyed by a surveyor of ships and her tonnage ascertained. (See p. 6 and Chapter IV of this Part.) The surveyor grants a certificate, which must be delivered to the registrar before registry.

Marks

Every ship before registry must be marked permanently and conspicuously to the satisfaction of the Board of Trade, with her name on each of her bows, and the name and port of registry on her stern in the required letters; her official number and number denoting registered tonnage must be cut on her main beam, and a scale of feet denoting her draught of water on each side of her stem and on her stern post in letters of the required size.

The Board of Trade may exempt certain ships from these requirements, and fishing boats are subject to special conditions. (See Chapter IV of this Part.) Penalties are imposed for inaccuracies, alterations, obliterations, &c.

Declaration of Ownership

Before registration, a declaration is required to be made and signed as to ownership, giving particulars of qualification to own, conditions of building, name of the master, and holding of shares, and stating that no unqualified person is entitled to any interest. In addition, on the first registry of a ship, evidence is required as to various matters, including the builders' certificate of a British-built ship; and the same of a foreign ship unless the time and place of her building are declared to be unknown or a builders' certificate cannot be procured, when a bill of sale must be produced; and in the case of a ship condemned, an official copy of the condemnation is required.

Particulars Registered

The registrar enters in the register book particulars of the name of the ship and port to which she belongs, the details in the surveyor's certificate, particulars respecting the origin of the ship, and the name and description of her registered owner or owners, and the proportion in which they share. The registrar retains the documents in his possession.

Certificate of Registry

On completion of the registry the registrar grants a certificate of registry, which must only be used for the lawful navigation of the ship, and must not be detained from the person entitled. The improper use of the certificate is a misdemeanour, and subjects the ship to forfeiture.

A new certificate can be granted, under certain conditions, on the delivery up of the old one, or in the event of its loss or destruction.

Change of master or ownership must be endorsed on the certificate. The certificate of a ship which is lost or captured or ceases to be British-owned must be delivered up to the registrar. Every owner must give notice of such loss or change to the registrar, and the registry in his book is then closed, except as to unsatisfied mortgages.

Provisional certificates are issued by consular officers for ships becoming British-owned abroad; and temporary passes in lieu of certificates are issued under special circumstances.

In case of doubt as to the registration of a ship, a Commissioner of Customs may direct a registrar to require evidence of its title to be registered as a British ship, and if satisfactory evidence is not forthcoming the ship may be forfeited.

Alterations

Alterations in a ship in respect of tonnage and description must be registered in accordance with the regulations, or a ship may be directed to be registered anew. Default in re-registering subjects the owner to heavy penalties. On change of ownership the registrar may register the ship

anew. The registry of any ship may be transferred from one port to another.

A ship which has been wrecked or abandoned, or for any other reason other than capture by the enemy or transfer to a person not qualified to own, cannot be re-registered until after survey and being certified as seaworthy.

Registration Abroad

Where there is British jurisdiction at any foreign port, that port may be declared by Order in Council a port of registry. In British possessions the Governor occupies the place of the Commissioners of Customs, and may approve a port for the registry of ships.

Returns by Registrar

Registrars in the United Kingdom are required to make monthly returns, and every other registrar periodical returns, to the Registrar-General of Shipping and Seamen of all registries, transfers, transmissions, mortgages, and other dealings, and the names of persons concerned and other particulars, as required. On 1 February and 1 August every registrar in the United Kingdom must furnish a list of all ships registered at their ports, and of those registrations which have been transferred or cancelled since the last return.

Forgery of material documents is a felony, and making a false declaration before the registrar a misdemeanour.

TRANSFER OF A SHIP

A registered ship or any share in it can only be transferred by bill of sale, otherwise the sale of a ship is subject to the ordinary conditions as in the case of sale of goods. The bill of sale must contain the description of the ship as in the surveyor's certificate or some other sufficient description to the satisfaction of the registrar, and must be in the statutory form. (See Form 1, p. 9.) No stamp is required.

Where a transfer takes place, the transferee to be entitled as registered owner must sign a declaration of transfer, containing a statement of his qualification to own a British ship, and a declaration that to the best of his knowledge and belief no unqualified person is entitled as owner to any legal or beneficial interest. The duly executed bill of sale must be produced to the registrar of the port of registry with the declaration, and he thereupon enters up the transfer and endorses the bill of sale.

Where property in a ship, or a share in it, is transmitted by the marriage, death, or bankruptcy of the registered owner, or by other lawful means other than transfer, a declaration of transmission must be made with the required proof. If a person who succeeds is not qualified to own a British ship, a sale may be prescribed by the Court and the proceeds paid to the persons entitled. On the application of an interested person the Court may prohibit for a time any dealing with a ship or share.

It will be observed from the form of a bill of sale (p. 9) that with the ship is transferred "her boats, guns, ammunition, small arms, and appurtenances".

Under certain circumstances a British ship is liable to forfeiture, e.g. if the owner is not British, or if an illegal use is made of the certificate or flag. Certain other offences are noticed hereafter.

MORTGAGES

A mortgage of a ship must be in the form prescribed by the Act. (See Form 2, p. 11.) In order to secure priority mortgages must be registered, and are recorded in order of production; and entries are also made of the discharge of the mortgage. Mortgages are entitled to priority according to the date of record and not of the mortgage, but as between the immediate parties registration is not compulsory to validate the mortgage.

The mortgagee is not treated as owner. He has a power of sale, but unless he takes possession he is not entitled to freight earned. A mortgagee is bound by the ship's engagements, unless they injure his security; but if the dealings with a ship are inconsistent with the sufficiency of the mortgagee's security he can take possession, although there is no actual default on the mortgagor's part. His security is not affected by the bankruptcy of the owner.

A mortgage may be transferred in the form prescribed by the Act, and the interest of the mortgagee may pass on death, or bankruptcy, or by other lawful means, when duly authenticated by a declaration.

Certificates of Mortgage and Sale

It may often happen that a sale or charge upon

a ship is effected away from the port of registry. A registered owner who desires to deal with the ship out of the country in which the port of registry is may obtain from the registrar a certificate of mortgage or sale which enables someone else to act for the owner. The owner must first state to the registrar certain particulars, including the name of the person by whom the power is to be exercised, the maximum amount of a mortgage charge or minimum price at which a sale is to be made, if fixed, the place where the power is to be exercised or a declaration that it may be exercised anywhere, and the limit of time during which the power is to be in force.

Such a certificate must contain a statement of the particulars required to be entered in the register book, and an enumeration of any registered mortgages or certificates affecting the ship. Rules are prescribed as to the method in which the certificate of mortgage may be exercised and as to the effect it will have. Rules are also prescribed with regard to certificates of sale, which must be of the entire ship. In the case of loss of the certificate of mortgage or sale, the registrar, with the sanction of the Commissioners of Customs, may issue a new certificate or direct entries in the register book. A certificate may be revoked by the owner giving notice in writing to the registrar.

NAME AND NATIONALITY

Name

The ship must always be described by its registered name. Any change requires the permission of the Board of Trade, and must be duly made in the register book, the ship's certificate, and on the ship's bows and stern. The Board of Trade may refuse a name already in use or one calculated to deceive.

National Character and Flag

Before a clearance or transire of any ship is granted by the Customs, the master must declare the name of the nation to which she belongs. A ship attempting to proceed to sea without such clearance may be detained.

A ship unduly assuming the British flag is liable to forfeiture, and a British ship concealing its character or assuming a foreign character is liable to forfeiture, and in the latter case the master is guilty of a misdemeanour. The interest of an unqualified person in a British ship is subject to forfeiture.

The red ensign usually worn by merchant ships is the proper national colour for all ships and boats belonging to any British subject, except His Majesty's ships or boats or others allowed by the Admiralty. The carrying of improper colours is subject to a fine not exceeding £500.

A British ship must hoist the national colours, on a signal from one of His Majesty's ships, on entering or leaving any foreign port; and if of 50 tons gross tonnage or upwards, on entering or leaving any British port. In default the master is liable to a penalty of £100. This does not apply to fishing boats.

Forfeiture proceedings may be taken by any naval or military officers, officers of Customs, and Consular officers.

MEASUREMENT AND TONNAGE

Before registration, the tonnage of every ship must be ascertained.

Rules are provided by the Act for the measurement of a ship and tonnage (secs. 77–87 and Schedule II). Allowance is made for engine-room space, and deductions are made from the measurement of the tonnage in respect of space for the accommodation of master, seamen, and apprentices; space used exclusively for the working of the helm, capstan, or anchor gear, or keeping charts, signals, &c.; space occupied by donkey engine and boiler if connected with main pumps; space adapted (other than a double bottom) for water ballast; and in the case of a sailing ship storage space for sails, and for certain special cases.

MARITIME LIEN

Maritime lien has been recognized by the laws of most nations. In some cases foreign law gives a lien on the ship for debts contracted by the master for necessaries. There is not under British law an implied lien on the ship for repairs and necessaries; there must be an express agreement. But a statutory lien has been given in the case of master's and seamen's wages, salvage, and damages due to collision. (See also Chapters III, V, and VIII of this Part.)

THE EMPLOYMENT OF THE SHIP

The owners themselves, although as we have seen the majority have a deciding voice, are often not engaged actually in employing the ship. That may be in the hands of a part owner, managing owner or ship's husband (as he is called), or other agent. In the case of a shipping company it is of course in the hands of the directors and managers.

The owners of a general ship are liable as common carriers (see Part V, Chapter V) to the cargo owners, and to strangers for damage caused to the ship see Chapter VI, as to passengers see Chapter IV of this Part.

SHIP'S AGENTS

In connection with shipping special forms of agency arise, although in the absence of agreement or established custom the ordinary rules of principal and agent apply, as stated in Part III, Chapter II. In days gone by a much wider latitude was necessarily allowed to agents for a ship than to other classes of agents, in consequence of the difficulty of communicating with their principals, who might be in another part of the world, separated from them by weeks or months. But ocean cables have changed all this, and it is probable that there are few cases in which a master or other shipping agent is called upon to act from necessity because he cannot take the immediate instructions of his owners.

The principal classes of agents are the managing owner, appointed by and acting for the other owners of the ship, or the ship's husband, the broker, and the master.

Managing Owner

A managing owner is usually appointed by the owners as general agent for the employment of the ship. The name and address of the managing owner of every ship registered at a port in the United Kingdom must be registered at the Custom House of that port; or if there is no managing owner, then the name of the ship's husband or other person to whom the management is entrusted must be registered, and he is under the same obligations as a managing owner. The penalty for default is £100.

The duties of a managing owner include the arrangements as to the employment, equipment, and repair of the ship, and payment of the ship's accounts, the engagement of the crew, and generally as to navigation, loading and discharge of the ship, which latter operations are, of course, carried out by those specially responsible. A managing owner should be appointed under written terms clearly setting out what his authority is, but in the absence of any such authority he can pledge his co-owners' credit for necessary repairs where he cannot consult them. He would have to show very special circumstances to bind them by a loan which he had contracted. Unless he has express instructions to the contrary, a managing owner has power to enter into a charter with its necessary incidents, but he cannot vary or cancel a charter which has already been entered into. He cannot assign the whole freight to secure advances made to him.

Ship's Husband

A ship's husband is a confidential agent appointed by the owners with duties similar to those of a managing owner. He is usually a part owner.

Brokers

Ship brokers are engaged either in the sale of ships or in securing freight. They may be specially engaged to act in connection with a certain charter or voyage, or may be the general brokers for a ship or shipping line; the terms of engagement in every case being clearly laid down. Brokers are generally remunerated by commission. Brokers employed for loading have the duty of collecting the freight, entering and clearing the ship, and dealing with Customs where a ship is not chartered. Where the whole of the ship's cargo is not provided for, it is the duty of the brokers to advertise for cargo and arrange the terms, issue bills of lading, &c.

Insurance Brokers

Insurance brokers are agents for negotiating the insurance of ships and adjustment of claims. They have a lien on the policy for the premium and their commission. (See also Chapter IX of this Part.)

The Master

The master as mariner is considered elsewhere (see Chapter III of this Part), but as agent of

the shipowners, and in certain cases of the cargo owners, he has very important functions. The master is appointed by the majority of the owners, with due regard to the general interest and requirements. He must give his full time and attention, and make no profits beyond those agreed—a possible exception is that by long usage known as primage. This is a small percentage or other gratuity payable by the freighter to the master, unless the latter has agreed that it shall be payable to the owners.

The master contracts as agent for the owners, but he is also personally liable on his own contract. It is not usual for the master to enter into a charter party, but if he is in a foreign port and cannot communicate with his owners, an act done without any suspicion of fraud would bind the owners. His contract, if the assent of the owners were given, will be binding when made elsewhere. He binds the owners by his contracts for repairs and necessaries, having an implied authority to pledge their credit for these purposes; but his authority to borrow money for other purposes of the ship is very limited if the owner has an agent at the port or near. Generally a master can only pledge the owners' credit when his necessity is very great and he has no opportunity of communicating with them, and then only for necessaries.

The master has little authority when the ship is in port, and he will generally find his instructions awaiting him on arrival at a port. Before arrival he could not enter into an advance agreement by writing, nor has he any power to vary a charter. He can only do things necessary for the carrying of it out. He has authority to sign bills of lading for goods actually received, *prima facie* as agent of the registered owner, and even on change of ownership till suspended. He should not sign the bill of lading in his own name, for that would make him personally liable. (See also Chapter VI of this Part.)

On the voyage a master has duties both as agent for the owner of the ship and the owners of the cargo, and to a certain extent he has power to bind both. Where he is not specially directed to the contrary, he sometimes has an agency arising from necessity when called upon to act in special circumstances and he cannot obtain instructions from his owner. He can then do what a prudent man would do under the circumstances who was acting in good faith. He has no right to deal with the cargo otherwise than in accordance with the terms of the contract, without making every effort to communicate with the owners. His ordinary duty is to take care of the goods and adopt every reasonable means for preventing their loss or damage, so that they may be delivered in due course. But, in the case of perishable goods, if they are in danger of loss and cannot be stored, or have been damaged so that to carry them to their destination would be impossible or useless and the only prudent course is to dispose of them, he may sell them in whole or part. Extreme caution must then be exercised. In the same way, if the vessel is hindered by obstacles which cannot be overcome, he may be justified in transhipping the goods to another vessel.

Bottomry and Respondentia

Under exceptional circumstances, when the voyage cannot otherwise be completed and it is the only possible course to take, the master may raise money on the ship, or if the owner's credit is exhausted he may raise money on the cargo, either by sale of part or by a loan on the security of the cargo. His duty to the cargo overrides that to the ship, and he must only resort to the cargo for the purpose of raising money when the shipowner's credit is exhausted.

A master under necessity, and when he cannot communicate with the owners, may borrow on the security of the ship by *bottomry bond*, engaging on behalf of the owners for the repayment of principal and interest if the ship shall arrive safe at the port of destination. By a contract of *respondentia* a loan is secured on the cargo which is or has been laden. Both of these contracts differ from loans made on mere personal security, which are repayable in any event. The bond need not be in any particular form. It will mention the necessity for the loan and contain an undertaking to complete the voyage, binding the master, his representatives, and goods, and the ship, tackle, &c., and freight, to repay the amount advanced with the agreed interest within so many days after arrival. It will generally provide that if the ship does not not arrive the loan and interest shall not be recoverable.

A *respondentia* bond (contracted for the benefit of the cargo) will charge the cargo in a similar way.

It is necessary that the master, if possible, should communicate with his owners, or cargo owners, as the case may be, and he must be acting under necessity and unable to raise money on his personal credit. It is therefore the duty of the lender to make enquiry and satisfy himself that the advance is sought *bona fide* and under stress of circumstances. In any case the bond must be conditional on the maritime risk; that is, the money is only payable if the ship or the cargo on which it is secured arrives safely. It is

the law of the ship's flag which governs the master's contract.

Jettison

Under stress of circumstances the master has also authority to jettison the whole or part of the cargo, in such a case acting as agent for the cargo owner, and under the necessity of the circumstances taking the only prudent course. He may choose among the cargo what shall be sacrificed. If there was no necessity to sacrifice the cargo, he would be held to have acted as agent for the shipowner, who would be liable for his acts and answerable for the loss to the cargo owner. (See also Chapter VI of this Part.)

It is also the master's duty to collect the general average contribution, or to retain the cargo until the amount is paid or tendered or secured, and he must furnish all cargo owners with accounts and particulars necessary for the average adjustment. (See also Chapter IX of this Part.)

Substituted Master

A *substituted master*, if properly appointed to act in default of the master, may do what a master would be justified in doing under the circumstances.

FORMS

Form 1: Bill of Sale

Official Number.	Name of Ship.	Number, Date, and Port of Registry.

Number, Date, and Port of previous Registry (if any).

Whether British or Foreign built.	Whether a Sailing or Steam Ship; and if a Steam Ship, how propelled.	Where built.	When built.	Name and Address of Builders.

			Feet.	Tenths.
No. of Decks	Head	Length from forepart of Stem, under the bowsprit, to the aft side of the Head of the Stern-post		
No. of Masts	Framework and description of vessel... ...	Length at quarter of depth from top of weather deck at side amidships to bottom of keel		
Rigged ...	No. of Bulkheads	Mainbreadth to outside of Plank		
Stern ...	No. of Water-ballast Tanks and their capacity in tons ...	Depth in Hold from Tonnage Deck to Ceiling at Midships		
Build ...		Depth in Hold from Upper Deck to Ceiling at Midships in the case of three Decks and upwards		
Galleries ...		Depth from top of Beam amidships to top of Keel ...		
		Depth from top of Deck at side amidships to bottom of Keel		
		Round of Beam		
		Length of Engine Room, if any		

PARTICULARS OF DISPLACEMENT

Total to quarter the depth from weather deck at side amidships to bottom of keel ... ... tons.	Ditto per inch immersion at same depth ... tons.

PARTICULARS OF ENGINES (IF ANY)

No. of Engines.	Description.	Whether British or Foreign made.	When made.	Name and Address of Makers.	No. of and Diameter of Cylinders.	Length of Stroke.	N. H. P., I. H. P., Speed of Ship.
	Engines.		Engines.	Engines.			
	Boilers. Number ... ... Iron or Steel ... Pressure when loaded		Boilers.	Boilers.			

PARTICULARS OF TONNAGE

GROSS TONNAGE.	No. of Tons.	DEDUCTIONS ALLOWED.	No. of Tons.
Under Tonnage Deck		On account of Space required for Propelling Power	
Closed-in Spaces above the Tonnage Deck, if any:		On account of Spaces occupied by Seamen or Apprentices, and appropriated to their use, and certified under the regulations scheduled to this Act. These Spaces are the following, viz.:—	
Space or Spaces between Deck...		On account of space used exclusively for accommodation of master, for the working of the helm, the capstan, and the anchor gear, or for keeping the charts, signals, and other instruments of navigation, and boatswain's stores, and for space occupied by donkey engine and boiler, and in case of sailing ships for space used for storage of sails	
Poop			
Forecastle			
Roundhouse			
Other Closed-in Spaces, Spaces for Machinery, Light and Air, if any			
		Cubic Metres.	
Gross Tonnage			
Deductions as per Contra ...			
Registered Tonnage		Total Deductions ...	

* ..... in consideration of the sum of ..... paid to † ..... by ..... the receipt whereof is hereby acknowledged, transfer ..... shares in the ship above particularly described, and in her boats, guns, ammunition, small arms, and appurtenances, to the said .....

Further ‡ ..... the said ..... for § ..... heirs covenant with the said ..... and ‖ ..... assigns, that ¶ ..... have power to transfer in manner aforesaid the premises hereinbefore expressed to be transferred, and that the same are free from incumbrances ** .....

In witness whereof ..... ha..... hereunto subscribed ..... name ..... and affixed ..... seal this ..... day of ..... One thousand nine hundred and ....

Executed by the above-named .....
in the presence of .....

* "I" or "we."
† "Me" or "us."
‡ "I" or "we."
§ "Myself and my" or "ourselves and our."
‖ "His," "her," or "their."
¶ "I" or "we."
** If there be any subsisting Mortgage, or outstanding Certificate of Mortgage, add "save as "appears by the Registry "of the said Ship".

NOTE.—A Purchaser of a Registered British Vessel does not obtain a complete title until the Bill of Sale has been recorded at the Port of Registry of the Ship; and neglect of this precaution may entail serious consequences.

Form 2: Mortgage of Ship

[*Insert description of ship and particulars as in Bill of Sale*]

TO SECURE PRINCIPAL SUM AND INTEREST

(a) ..... the undersigned ..... in consideration of ..... this day lent to (b) ..... by ..... do hereby for (c) ..... and (d) ..... heirs, covenant with the said .... firstly That (a) ..... or (d) ..... heirs, executors, or administrators, will pay to the said ..... the said sum of ..... together with interest thereon at the rate of ..... per cent per annum on the ..... day of (f) ..... next; and secondly, that if the said principal sum is not paid on the said day (a) ..... or (d) ..... heirs, executors, or administrators, will, during such time as the same or any part thereof remains unpaid, pay to the said .... interest on the whole or such part thereof as may for the time being remain unpaid, at the rate of ..... per cent per annum, by equal half-yearly payments on the ..... day of ..... and ..... day of ..... in every year; and for better securing to the said ..... the repayment in manner aforesaid of the said principal sum and interest (a) ..... hereby mortgage to the said ..... shares, of which (e) ..... the Owner ..... in the Ship above particularly described, and in her boats, guns, ammunition, small arms, and appurtenances. Lastly, (a) ..... for (c) ..... and (d) ..... heirs, covenant with the said ..... and ..... assigns that (a) ..... ha..... power to mortgage in manner aforesaid the above-mentioned shares, and that the same are free from incumbrances (g) .....

In witness whereof (a) ..... ha..... hereto subscribed (d) ..... name ..... and affixed (d) ..... seal ..... this ..... day of ..... One thousand nine hundred and .....

Executed by the above-named .....
in the presence of .....

(a) "I" or "we."
(b) "Me" or "us."
(c) "Myself" or "ourselves."
(d) "My" or "our."
(e) "I am" or "we are."
(f) Insert the day fixed for payment of principal as above.
(g) If any prior incumbrance add, "save as appears by the Registry of "the said Ship".

NOTE.—The prompt registration of a Mortgage Deed at the Port of Registry of the Ship is essential to the security of the Mortgagee, as a Mortgage takes its priority from the date of production for registry, *not from the date of the instrument.*

CHAPTER III

MASTER AND SEAMEN

Master and Officers—Seamen—The Official Log—Administrative Bodies—The Merchant Service as a Career

MASTER AND OFFICERS

The master as agent of the owners has already been considered. It now becomes necessary to consider his qualifications as master mariner, his command and navigation of the ship, and control of the crew and all those on board. It is obvious that special qualifications, apart from the certificate which the law demands, are needed from one in a position, not only of great trust, but demanding powers of application throughout the whole engagement and of the utmost resolution and courage in the event of emergency. These qualifications are required in only a slightly less degree in all the other officers of the ship, from the first mate downwards. The appointment of the master, as we have seen, is with the majority of the owners. On a sudden vacancy the first mate succeeds for the time.

The duties of the master to his owners are first and always to secure the safety of the ship, to avoid injury and to undertake repairs when necessary, and repel all attacks upon her from within or without. He must take a pilot on board when required (see Chapter V of this Part), and he must observe other requirements of the law, as, for example, the keeping of the log (see p. 17).

The master's authority on board extends over the crew and passengers. He may be dismissed by the owners under his agreement or for violation of it. A master may also be removed, or his competency enquired into by the Court, and his certificate may be suspended or cancelled by the Board of Trade, or by a Wreck Commissioner after a casualty. (See Chapter V of this Part.)

A master for his wages and disbursements has his claim against the owners and also a lien on the ship. His claim for wages comes after that of the seamen and before any other claims, unless he has made himself personally liable.

The Merchant Shipping Act describes the standard of qualification as follows:—

Every British foreign-going ship, and every British home-trade passenger ship, when going to sea from any place in the United Kingdom, and every foreign steamship carrying passengers between places in the United Kingdom, must be provided with duly certificated officers. In any case there must be a duly certificated master, and, if the ship is of 100 tons or upwards, at least one additional officer holding a certificate not lower than that of mate in the case of a home-trade passenger ship, second mate in the case of a foreign-going sailing ship of not more than 200 tons, or only mate in the case of any other foreign-going ship. If the ship is a foreign-going ship and carries more than one mate, there must be at least a first and second mate duly certificated; and if the ship is a foreign-going steamship of 100 nominal h.p. or upwards, at least two engineers, one first class and the other first or second class, duly certificated. Such a ship of less than 100 nominal h.p., or a sea-going home-trade passenger steamship, must have at least one first- or second-class engineer duly certificated. It is in practice quite common for mates to hold masters' certificates.

If any person having been engaged as officer goes to sea without being duly certificated, or employs an uncertificated person as officer, he is liable to a penalty of £50.

"Foreign-going ship" includes every ship employed in trading or going between some place or places in the United Kingdom and places beyond the limits, that is, the coasts of the United King-

dom, the Channel Islands, and Isle of Man, and the continent of Europe between the River Elbe and Brest inclusive.

"Home-trade ship" includes every ship employed in trading or going within the limits of the United Kingdom, the Channel Islands, and Isle of Man, and the continent of Europe between the River Elbe and Brest inclusive.

Training and Certificates

Certificates of competency are granted in the following grades:—

Master of a foreign-going ship; first mate of a foreign-going ship; second mate of a foreign-going ship; only mate of a foreign-going ship; master of a home-trade passenger ship; mate of a home-trade passenger ship; first-class engineer; second-class engineer.

An extra-master's certificate is the highest. The certificate for a foreign-going passenger ship is of higher grade than the certificate for a home-trade ship, and entitles the holder to go to sea in the corresponding capacity in the home-trade ship, but the converse does not hold. For the purpose of granting certificates examinations are usually held by the local Marine Boards at their respective ports, under rules made by the Board of Trade. For granting certificates to engineers, however, the examinations are held as the Board of Trade directs. Certain naval officers are entitled to certificates without examination.

Certificates are in duplicate, one part being delivered to the person entitled and the other preserved by the Registrar-General or other person appointed.

Provisions are made for the granting of certificates in the Colonies. Certificates of competency must be produced to the authorities. Forgery of, and false representation as to, and fraudulent use of certificates are misdemeanours. (See further as to Training and Certificates, pp. 18, *sqq.*).

SEAMEN

Apprenticeship

Special provisions are contained in the Act relating to apprenticeship of boys to the sea service, and of pauper boys by Boards of Guardians and others. The indenture of apprenticeship must be executed in duplicate, is exempt from stamp duty, and must be recorded by the Registrar-General. The master of a foreign-going ship must produce the apprentice to the superintendent before whom the crew are engaged before sailing from the United Kingdom.

Licences to Supply Seamen

In order to secure that fair treatment shall always be given to merchant seamen it has been provided that their engagement shall take place before a public official, and that persons who act as agents for the procuring of crews shall be licensed.

Licences may be granted to such persons by the Board of Trade to engage or supply seamen or apprentices for merchant ships in the United Kingdom. Penalties are imposed for acting without a licence. No remuneration other than the authorized fees can be demanded or received by the person from the seamen or apprentices for finding employment.

Engagement of Seamen

The master of every ship, except those of less than 80 tons registered tonnage, exclusively employed in trading between different ports of the United Kingdom, must enter into an agreement with every member of the crew, as required by the Act. There is also an implied term in the agreement or "ship's articles" that all reasonable means have been taken to ensure the seaworthiness of the ship for the voyage. This cannot be affected by any agreement to the contrary. Carrying any seaman to sea without an agreement subjects the master of a foreign-going ship, and the master or owner of a home-trade ship, to a fine of £5. The agreement must be in the form approved by the Board of Trade, and must be dated at the time of the first signature, and first signed by the master and then by the seaman. It must contain particulars of the nature and probable duration of the voyage or engagement, or the maximum period of the voyage or engagement, and the places to which it extends; number and description of the crew, specifying how many are engaged as sailors; time at which each seaman is to be on board or begin work, and the capacity in which he is to serve; wages of each seaman; scale of provisions; regulations as to conduct on board; fines, &c., as approved by the Board of Trade. The agreement must be framed so as to admit of stipulations respecting the advance and allotment of wages.

The agreement with the crew made in the United Kingdom, in the case of foreign-going ships, must be signed by each seaman in the

presence of, and attested by, a superintendent of a Mercantile Marine Office, after it has been read and explained. One part of the duplicate agreement must be retained by the superintendent and the other delivered to the master. There may be agreements for the voyage and running agreements. A seaman must not be engaged in the British Isles, or any port between the Elbe and Brest, who does not know sufficient English to understand the necessary orders. Provision is also made for the engagement of substitutes, and for the endorsement of running agreements on return to port.

As regards home-trade ships, the agreement may be made either for service in a particular ship or in two or more ships belonging to the same owner, the names of the ships and the nature of the service being specified. If the crew are not engaged before a superintendent the master, or the owner in the case of service in two or more ships, before the ship puts to sea or as soon after as possible, must cause the agreement to be read and explained to each seaman before he signs. There is a restriction as to the time of service in the case of ships of more than 80 tons burden.

Changes in the crew of foreign-going ships must be notified to the nearest superintendent by the master.

After the due execution of the agreements for the crew a certificate is granted to the master by the superintendent, and he must produce it to the officer of Customs before proceeding to sea.

As a definite statement of the intended voyage must be given in the agreement, deviation from the course laid down, unless within a qualified alternative, will relieve the seamen from their agreement, and so when the agreed time is exceeded. In a similar way, if the number of hands is reduced to an unreasonable crew, the agreement is invalidated.

The master of a foreign-going ship must within forty-eight hours after arrival at a final port of destination in the United Kingdom, or upon the discharge of the crew, deliver his agreement with the crew to the superintendent and obtain a certificate of that delivery; otherwise the Customs will not clear the ship inwards. Failure to deliver the agreement without a reasonable cause is an offence.

The master or owner of a home-trade ship of more than 80 tons burden must within twenty-one days after 30 June and 31 December deliver to the superintendent every agreement with the crew made within the six months preceding, and obtain a certificate. The ship will be detained unless the certificate is produced, and non-compliance without a reasonable cause is an offence.

A copy of every agreement must be accessible to the crew. Punishments are provided for forgery and falsification. Alterations when made must be witnessed. Seamen are not bound in any proceedings to produce the original agreement.

Seamen abroad are engaged before a British Consular officer or superintendent or officer of Customs.

Special provisions apply to agreements with lascars, and stipulate for their return to the East.

Rating and Discharge of Seamen

A seaman is not entitled to the rating of A.B. unless he has served at sea for three years before the mast, but the employment of fishermen in registered decked fishing vessels only counts as sea service up to the period of two years of that employment. The rating of A.B. is only granted after at least one year's sea service in a trading vessel, in addition to two or more years' service on such fishing vessels. Service is proved by certificates of discharge or of service issued by the Registrar-General or in other satisfactory ways. (See also page 21.)

A seaman serving in a British foreign-going ship, discharged in the United Kingdom on the termination of his engagement, must be discharged in the presence of a superintendent. A certificate of discharge must be given to the seaman by the master, specifying length of service, and the master must return his certificate of competency to every certificated officer. The master must make and sign a report of the character, conduct, and qualifications of the seaman discharged before a superintendent, or make a statement that he declines to give any opinion. Making a false report or forged certificate is a misdemeanour.

Payment of Wages

When a seaman is discharged before a superintendent in the United Kingdom, he must generally receive his wages through or in the presence of the superintendent. The master must deliver a wages account. Deductions are only allowed which have been duly entered in a book during the voyage. In the case of a foreign-going ship, except where seamen have agreed to be wholly compensated by share of profits, provisions are made as to the time of payments on account and final settlements; and other provisions in the case of home-trade ships; and for the settlement of disputes by a superintendent where the amount does not exceed £5, or otherwise by agreement.

Advance and Allotment of Wages

Stipulations may be made in the required agreement for the advance of wages, and for the allotment of a seaman's wages, in accordance with regulations.

Stipulations as to the allotment of any part of a seaman's wages during his absence for the benefit of relatives or to be paid into savings banks must be inserted in the agreement. Allotment notes must be in the approved form.

Facilities are given for remitting seamen's wages by money order issued by superintendents, and seamen's savings banks may be maintained by the Board of Trade.

Right to Wages

A seaman's right to wages and provisions begins when he commences work, or at the time specified in the agreement for the commencement or his presence on board. Wages accrue monthly. A seaman has a lien on the ship for earnings. He cannot forfeit it or abandon his right to salvage by agreement. The right to wages does not depend on earning a freight; but a seaman who does not, in case of wreck or loss of the ship, exert himself to the utmost loses his claim to wages.

Where service abruptly terminates through wreck or loss of the ship or a seaman being left on shore for unfitness or inability, he is entitled to wages to the time of such termination. When on a voyage to New York the ship had to put back for repairs in consequence of a collision just after leaving Southampton and the certificate was suspended for two months this was held to be "a wreck". Seamen were only entitled to wages to the time they were discharged on the vessel going back to Southampton (*The Olympic* (1912)).

Wages do not accrue during refusal to work or imprisonment, and are forfeited by desertion, quitting the ship before time, or misconduct, or if illness is caused by the seaman's own default; and a seaman's wages may be forfeited to meet a fine incurred by the ship through his desertion. Forfeiture of wages may, however, be waived by a master taking the seaman on again.

A seaman improperly discharged is entitled to compensation.

Wages due or accruing due to a seaman or apprentice are not subject to attachment or arrestment from any Court or to assignment or sale.

A seaman or apprentice, or a person on his behalf duly authorized by him, may sue for wages not exceeding £50 in a Court of Summary Jurisdiction. Proceedings must not be instituted in any superior Court, unless the owner of the ship is bankrupt or the ship is under arrest or sold by the authority of the Court, or a Court of Summary Jurisdiction refers the claim, or where neither owner nor master resides within twenty miles of the place where the seaman or apprentice is discharged.

Where the engagement is to terminate in the United Kingdom, a seaman cannot sue in any Court abroad, unless he is discharged with the required sanction or consent of the master, or proves ill-usage such as to warrant reasonable apprehension of danger to his life on board. In such cases of misconduct or default of the master or owner, the seaman may recover compensation in addition to wages.

The Court has power in any dispute between owner or master and seaman or apprentice to rescind the contract on terms.

Property of Seamen

The property of a seaman or apprentice who has died on the voyage is to be taken charge of by the master and the particulars duly entered in the log book. His effects may be sold by auction at the mast or otherwise.

The master must report the death at the nearest port to the British Consular officer or officer of Customs, giving such account as is required of the seaman's property. Property of a deceased seaman left abroad but not on board the ship is taken in charge by the chief officer of Customs for a British possession, or British Consular officer at any other place. These officials have similar powers of disposition.

The Act also provides for the recovery of wages or property of seamen lost with their ship or dying at home, and for disposal by the Board of Trade, subject to any valid will made by the seaman. A seaman actually at sea may dispose of his personal property by word of mouth; but as to money or effects in the hands of the Board of Trade, a written instrument made in the presence of and witnessed by the master or first or only mate, if on board, or by two official witnesses if on land, is required. (As to Wills, see Part III, Chapter XIII.)

Creditors cannot claim payment of their debts out of a deceased seaman's property if they accrued more than three years before the death or if demand is not made within two years after death. The Board of Trade may, after six years, if no claim is made to any deceased seaman's property, devote it to the Exchequer.

Poor-law relief of seamen's families may be charged on a certain proportion of their wages.

Destitute Seamen

Penalties are incurred if masters of ships leave Asiatic or African seamen in distress in the United Kingdom, and provisions are made for the relief of destitute lascars, and generally governing the discharge of seamen in foreign countries and their repatriation. Penalties are imposed for forcing seamen on shore or leaving them behind.

Distressed Seamen

The Merchant Shipping Act, 1906, contains provisions for dealing with the wages and effects of seamen of a British ship left behind out of the British Islands. International agreements are in force with certain foreign countries for mutual assistance to distressed seamen. The master must not discharge a seaman at any place out of the United Kingdom, except at a port in the country where he was shipped, without the sanction of the proper authority, and seamen must be repatriated on termination of their service at a foreign port.

In certain cases masters can be compelled to take home distressed seamen, and expenses of relief may be recovered from the ship; otherwise the expenses are paid out of public moneys.

Compensation for Accidents

The Workmen's Compensation Act, 1906, extended the rights of "workmen" to seamen, including masters and apprentices injured in the sea service and sea fishing service, and pilots.

Seamen must be workmen within the Act—that is, persons employed in earning not more than £250 a year or working manually, &c. (See generally Part III, Chapter X.) They must belong to the crew of a ship registered in the United Kingdom, or one owned or managed in the United Kingdom, and not to the crew of a profit-sharing fishing vessel. The Act has special provisions for the service of notices, making of claims and payments, and amount of compensation. Otherwise, the conditions as to compensation for injuries or death are the same as in the case of other workmen. Death must be proved to have been due to accident.

Health Insurance

The National Insurance Act, 1911, contains special provisions as to masters, seamen, and apprentices to the sea service and sea fishing service. As the Merchant Shipping Acts provide that seamen engaged in the foreign trade (not the home trade and coasting trade) must when ill be maintained and medically treated and paid full wages by the owner, seamen do not require, when on active service, the medical, sickness, or disablement benefits which are general under the Act. The employed and employers' contributions are each reduced by 1*d.* a week, and every four weekly contributions paid in any calendar year count as five. Seamen are entitled to the maternity benefit and sanatorium benefit at all times, and while at home to the medical, sickness, and disablement benefits. In addition, they are entitled to Long Service pensions. It is the duty of the Board of Trade to form under the Act the Seamen's National Insurance Society, which was designed to cover the special interests of masters and seamen, but not to the exclusion of other Societies. In the home and coasting trade the ordinary provisions of the Act apply.

Foreign seamen are not insured, but in order that there shall be no preference, employers' contributions are payable in respect of them, and enure to the benefit of British Seamen.

Volunteering for Royal Navy

Seamen may leave the ship to volunteer for the Royal Navy, a stipulation in an agreement that they shall not do so being void and an offence.

Provisions, Health, and Accommodation

The Act enables a crew to make a complaint as to the supply of provisions and water to officers of H.M. ships, Consular officers, superintendents, and others. Compensation to seamen may be ordered in the case of short or bad provisions.

The Merchant Shipping Act, 1906 (First Schedule), provides a statutory scale of provisions which is implied in agreements with the crew, and which may be varied by Order in Council. The master may be fined for failure. An inspector may inspect any provisions or water intended for the crew of any British ship, and detain the ship if he finds a deficiency. Where possible, inspection must take place before the provisions or water are shipped. Penalties may be imposed upon the master.

Every British foreign-going ship of 1000 tons and upwards gross tonnage must be provided with a duly certificated cook.

The Board of Trade regulations as to medicines, medical stores, anti-scorbutics, &c., must be observed. The medical inspector of the port inspects to see if the required medicines are provided.

The medical inspection of seamen is provided for. The provisions and water for the crew of ships trading from the United Kingdom through the Suez Canal or round the Cape of Good Hope

or Cape Horn are inspected according to regulations.

The expense of medical attendance of seamen, not due to the seaman's own fault, is to be borne by the owner. Every foreign-going ship with one hundred persons or more on board must carry a duly qualified medical practitioner.

Accommodation for Seamen

The accommodation for seamen in a British ship must be not less than 120 cubic feet, 15 superficial feet, and otherwise in accordance with the regulations.

A master must give facilities to a seaman who has expressed his wish to make a complaint to the authorities either at once or on arrival in port.

Protection of Seamen

In addition to the protection of their wages and property, seamen are protected from imposition from the fact that an assignment or sale prior to its accrual of salvage payable to them is invalid. No debt above five shillings is recoverable till the conclusion of service. Other provisions protect them and their property from fraud or duress, or overcharges by lodging-house keepers.

Discipline

The ordinary rules for good conduct on board ship must be observed by seamen, and punishment for their breach may be awarded. In the case of the more serious offences provisions are contained in the Act. Master, seamen, or apprentices for misconduct endangering life or the ship, for desertion or absence without leave, and for other offences against discipline, damaging ships, embezzling stores, or smuggling, are punishable. Penalties are also imposed on stowaways or deserters from other ships.

Fraudulent or criminal acts of the master or crew against the owners are punishable by the criminal law.

Barratry is a breach of duty with criminal or fraudulent intent endangering the ship, as by running ashore or engaging in smuggling without the knowledge of the owners.

Wilful destruction or damage to the ship or any part, and failure to resist enemies, are other unusual offences.

THE OFFICIAL LOG

An official log must be kept in every ship, except in ships exclusively trading between ports on the Scottish coast, in the form approved by the Board of Trade. Every entry must be signed by the master and by the mate or some other of the crew, in the case of illness by the surgeon, and in the case of wages by the seaman or officer authorized. Entries must be made in the log book of every conviction of a member of the crew, with the punishment inflicted, and of every offence which it is intended to prosecute or which is punished on board. There must also be entered a statement of the conduct, character, and qualification of each of the crew, or of any illness or injury happening to the crew, or any marriage taking place on board; the name of every member or apprentice who ceases to be a member of the crew. Various other entries must be made with regard to wages and property, as well as an entry as to every collision, and any other matters directed to be entered. A fine is imposed for failure to keep the log book, or for destroying or mutilating or rendering illegible any entry. Log books must be delivered to the superintendent of Mercantile Marine within forty-eight hours of a foreign-going ship's arrival at her final port of destination in the United Kingdom, and in the case of a transfer of a ship or her loss must be sent home. Log books of home-trade ships must be transmitted half-yearly.

ADMINISTRATIVE BODIES

Local Marine Boards

These Boards, for carrying the Act into effect under the superintendence of the Board of Trade, are set up at various ports and other places in the United Kingdom, and must report and make returns to the Board of Trade as required.

Mercantile Marine Offices

A Mercantile Marine Office, with the necessary staff, is maintained at every port in the United Kingdom where there is a local Marine Board, or may be established otherwise as the Board of Trade directs. Superintendents of Mercantile Marine Offices, as we have seen, must afford

facilities for engaging seamen by keeping registers, must superintend and facilitate their engagement and discharge, facilitate apprenticeships, and perform other duties relating to seamen, without taking any remuneration.

General Register and Record Office of Seamen

The General Register and Record Office of Seamen is maintained in London at Tower Hill, E., by the Board of Trade, under the control of the Registrar-General of Shipping and Seamen and his staff, who keep the register of all persons who serve in ships subject to the Act. The information must be forwarded by the masters of foreign-going ships and home-trade ships as required. Returns of births and deaths in British ships and of transfers or losses must be made by masters, and are forwarded to the Registrar-General of Births and Deaths.

Voluntary Societies

It is well known that a number of voluntary and philanthropic societies for the benefit of merchant seamen exist, and that sailors' institutes, clubs, homes, and rests are maintained in most ports. Local authorities in ports may grant sites for sailors' homes.

THE MERCHANT SERVICE AS A CAREER

Whatever may have been the case in the past, there is no denying that the opportunities of obtaining a competence in the executive branch afloat are not very great now. The conditions of employment afloat have altered so much within the last quarter of a century, that it cannot be said that the merchant service affords many opportunities for a satisfactory and well-paid career, though what constitutes this is a matter of comparison and opinion. The introduction of the electric telegraph, and the very general adoption of the steamship for commercial purposes, have tended to cut down the emoluments of captains, officers, and men. Before it was possible to obtain communication between almost any two ports by means of the telegraph, much had to be left to the discretion of the ship's captain, who was not only the chief navigating officer but also the owner's agent, and on his business ability and the arrangements he was able to make depended very largely the success of the voyage. In the days when those conditions prevailed, freights were much higher than they are now, and a ship often paid for herself in two or three voyages. Competition, though keen in respect to the number of vessels, was confined to vessels of moderate dimensions, mostly sailing ships of less than a thousand tons net register, but it had not then led to the extraordinarily poor freights which have prevailed on most trade routes in recent years. At one time the practice existed of permitting a certain amount of space to be utilized by the master, mates, and crew for trading on their own account, and the lowness of wages to the lower grades was compensated for by the gain resulting from this personal trading. This custom, thanks to time-tables for sailings, large steamships, keen competition, and the steady growth of the competition of foreign shipping, has long since died out. Now, the whole management of the adventure—to use the old term—is done at the offices ashore, and the ship, as a carrier of goods, has to keep to the time-table, while captain, officers, engineers, and crew are paid salaries which are calculated to the day.

As to the advisability of adopting seafaring as an occupation, much depends upon temperament, which indeed probably plays a more important part in this connection than in the case of most other professions. Unless a man has the seafaring instinct, the call of the sea, in him, he will never make a really successful sailor either as navigator or seaman, though he may by dint of perseverance attain to the command of a steamer or sailing ship. Without the necessary temperament he will probably consider a life at sea to be little else than ill-paid drudgery, but other circumstances have to be considered in deciding whether a satisfactory career is possible for the man who goes to sea. The great drawback is the precariousness of the employment.

Training

Although this is the age of steamships, four years' training in a sailing ship is considered necessary for those who intend to become officers. Any youth who thinks of going to sea should make his first voyage as an apprentice in a long-voyage sailing ship; he will either be disillusioned as to the romance of seafaring, or confirmed in his choice. To be a sailor, one must have more than the average physical robustness, and be possessed of a cheerful indifference to all kinds of inconvenience. The training is hard, expensive, and difficult for a landsman to understand, and it cannot be judged except by those who have

gone through it; but it must be admitted that when the circumstances of the training are taken into consideration, the acquisition of the knowledge necessary for the attainment of certificated rank is not beyond the mental capabilities of any youth of ordinary intelligence and average perseverance. In the matter of training and examinations all fare alike in theory, whether rich or poor; but in the actual sea training itself the possession of means, and subsequently of influence, will enable the intending officer to secure advantages which cannot fall to the lot of those who are less favourably situated. Mr. T. H. Devitt, of Messrs. Devitt & Moore, owners of the sea-going sailing ships *Port Jackson* and *Medway*, each of which takes a large number of cadets, stated in a recent interview that a point which is especially insisted upon is that the training of a marine officer should be an active sailing-ship training. Even if a boy is "going into steam", a previous sailing-ship foundation and instruction are invaluable to him. Having learned to depend upon weather and the manipulation of his own sails, he has acquired a resourcefulness and an instinctive command of the element on which he is manœuvring. There is no difficulty in finding suitable boys' ships when they have gained their second mate's certificates. The great shipping lines see that it pays them to keep close to a standard source of officers, so to speak, and a short time ago some of the larger lines agreed to give the boys trained on this firm's ships a kind of option in their steamships. The difficulty that was created by some firms only consenting to extend this so-called option to those who should become possessed of masters' certificates was overcome by other firms agreeing to take boys after their training on these sailing ships, without prejudice to the boys' future career upon the big lines when fully qualified. That a great number who try seafaring do not like it sufficiently well to make it their calling, even after experiencing the favoured conditions of these ships, is shown by the fact that only about 31 per cent of them become second mates.

Conditions

No youth wishing to go to sea to become a navigating officer can obtain a certificate of competency under any circumstances until he has passed the sight and colour test as laid down by the Board of Trade. The seagoing cadet ships and the better-class stationary training ships which cater for boys intending to become officers will not receive any youth who cannot pass this test as a preliminary. Any boy wishing to go to sea to become a navigating officer should pass the sight test at one of the local Marine Board offices before he signs his indentures as an apprentice. Some owners unfortunately do not insist upon this being done. If a boy is colour blind, or his sight is defective in other ways, he will not be allowed to enter for his second mate's certificate at the expiration of his four years' sea training, and it is better he should find this out at once than after spending four years at sea in preparing for an occupation in which he cannot possibly succeed. Failure means that he will never rise higher than the grade of a deck hand or A.B. if he persist in going to sea. The other branches of seafaring open to him are those of the marine engineer, the steward, and the cook. The superior training ships are restricted to those who can pay their fees, and their pupils naturally are, as a rule, of better social standing than those boys who are apprenticed in the ordinary way. Having passed the sight test and his examinations, if a youth is of good social manners and an agreeable personality, and has influential friends, he may find the way of promotion rendered comparatively easy, other things being taken into account, for all such advantages will be useless if he is not thoroughly competent in the discharge of his duties. The most influential friends cannot keep the duffer in command of a ship when once he has proved his incompetence or his unsuitability for the position. It may be taken as a general rule that every boy who receives the regular training of the *Conway* or *Worcester*, and chooses to go to sea, has excellent facilities for doing so. These vessels also train specially for admission to the college at Osborne with a view to entering the Navy. The *Worcester* pays special attention to the qualifications required of those who wish to enter the Indian pilot service, which is one of the best-paid branches of the mercantile marine, and is consequently much sought after. Both these vessels also have arrangements with the chief steamship companies for placing the youths on the steamships as apprentices or as supernumerary or junior officers upon completion of the term of apprenticeship on a sailing vessel. Two years on a recognized river training ship and three years at sea, or four years at sea if there has not been the preliminary training, must be spent before the sight test is again undergone and a second mate's examination can be entered for.

Apprenticeship

Most owners, whether of sail or steam, taking apprentices who have not had a first training insist upon the sight test as a preliminary. Some owners charge a premium for every apprentice and

pay it back in wages, some being generously disposed in this respect and others the reverse. Some charge no premium and pay very little as wages, while others take no premium and pay what must be considered good wages under the circumstances. Some give a bonus to those who complete their indentures, in addition to wages, and others pay a bonus without giving wages, or, at best, only a nominal sum per month or per voyage. The premiums vary in amount from nothing to £100. The particulars of these charges by the different firms can be obtained from the Board of Trade or the Government printers who issue a list of those owners of both sail and steam who take apprentices, and the conditions imposed. In addition to the premium or deposit, as the case may be, the expense of the outfit has to be met, which for the first voyage is seldom under £15 to £20 for an ordinary apprentice, and can only be done at that figure if he happen to have a good stock of clothes by him. To this must be added the cost of such books and nautical instruments as the owner of the vessel may consider necessary, or the captain, if it is in the contract that he is to teach the boy both navigation and seamanship. It should be insisted upon that both subjects should be included in the contract if the boy is to get the greatest benefit possible from his four years' training. The instruments and books may last a lifetime, and may often be bought secondhand, but clothes at sea are a very variable quantity, and there will be considerable renewals after every voyage. Thus for four years the apprentice has to be found by his friends or relatives in clothes, books, nautical instruments, and generally in pocket money, though the little he will receive from the owner may sometimes cover the last item. At the expiry of the four years he may or may not receive the bonus or return of premium, this depending on his agreement, as a set-off to the expense already incurred. He will probably have to spend a few weeks under a coach to be prepared for his second mate's examination, the fees for which tuition range from a minimum of a guinea, and his keep ashore has to be met. Then there are the fees for his examination, but these do not amount to a large sum. During the four years at sea the owner has to find him in food and accommodation of a sort. In the first year he is probably costing the owner more than he is worth. In the second year he may be of some value to the owner, and in the third and fourth he is probably a profitable investment so far as the owner is concerned. In some sailing vessels he may be given the honorary position of third mate for his fourth year, and this usually carries with it the privilege of having his food in the saloon. The expense to his relatives for the four years is not likely to be less than £50; it has been done for that, but the cost is generally more. Against this must be set the fact that for about nine months out of every twelve he has been fed and housed, but has been earning little or nothing.

Certificates

After securing his second mate's certificate, he may look out for a position on board a ship in the capacity in which he is now entitled to serve. He may ship at anything from £4 to £8 per month, food included; but the pay and engagement only last for the voyage, or from such time before it starts as his services may be required on board, for sometimes the mates have to superintend the loading of the cargo, and have to be on the ship two or three weeks before she sails.

The examination for second mate is designed to be a somewhat stiff test of his fitness for his profession. The minimum age is seventeen years. A dictation of not less than fifteen minutes' duration is imposed to ascertain that he can write a good legible hand and spell correctly. This qualification is equally necessary in the examination in navigation and that in seamanship. In the former the candidate will be required to write a short definition of various astronomical and other terms, and to draw an illustrative sketch or diagram. A good knowledge of the first five rules of arithmetic and the use of logarithms is necessary. He must also work out a day's work complete, correcting the courses or leeway, deviation, and variation; find the latitude by the meridian altitude of the sun; work a practical problem in parallel sailing; find the time of high water at a given port; and answer in writing certain questions as to taking the sun, compass error, deviation, variation, and true and magnetic bearings and the meaning of charts. He will also have to explain the use of the sextant, barometer, thermometer, hydrometer, and chronometer. Then there is the comprehensive subject of weights and measures. After this there comes the examination in seamanship, which relates to the standing and running rigging of ships, the handling of masts, sails, and yards under all circumstances, the management of a ship under canvas, and of a ship's boats in heavy weather, and the proper stowage of all kinds of cargo. Seamanship includes the rules for safety at sea, such as lights, flags, and other signals, the lead and log lines, and the rocket apparatus; and the examiner will supplement the written questions by any verbal questions he may think it necessary to ask. In spite of its apparently formidable proportions, the examination in both navigation and seaman-

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ship is not so difficult as it may appear at first sight. He must serve at sea for a year before he can enter for his first mate's certificate, and must pass another similar interval, this time in the latter capacity, before he can enter for his master's certificate. It is optional with him whether he takes his examination for the extra master's certificate, which is the highest in the power of the Board of Trade to bestow, at that time or later. Most officers make sure of the master's certificate first, and after some special coaching enter in a few weeks' time for the extra master's certificate. Of course it is optional to try for it, but preference will usually be given to the holder over a man who has not obtained one. The same conditions apply to those who wish to go in for a steamship training only. In their case the terms of the indentures vary slightly, the duties on board are different, and the examinations for the various grades differ, inasmuch as greater knowledge of machinery is requisite. The salaries of the first mates average about 50 per cent more than those of the second mates on the same boats. It follows that the navigating officers are sometimes paid less than their subordinates, the boatswains or carpenters, and this constitutes one of the grievances which officers have been seeking for a long time to have remedied. The grievance, however, exists only in a few lines. At each certificated stage the officer has been earning money, and at the end of each voyage he should have enough money in hand to enable him to reach the succeeding stage. As first mate he will receive from £7 to £12 per month. Very few receive as low an amount as the former figure, which is paid by certain cargo lines to men who are unable to get anything better, or are at the end of their resources.

Stationary Training Ships

For those youths who can afford them, there are the training ships *Conway*, moored in the Mersey near Liverpool, and the *Worcester*, anchored in the Thames off Greenhithe. The fees for the *Conway* are £22 10*s.* per term, or sixty-five guineas per annum, and there are three terms in the year with a long vacation in the summer. There are a few small extras, such as those for recreation; but the fees quoted include accommodation, a liberal dietary, and an excellent course of instruction, besides three suits of uniform every year, medical attendance, washing, and the use of the necessary books and school stationery. The charges for the *Worcester* also amount to sixty-five guineas per annum, payable as follows: first term, £33 10*s.*, and the second and third terms, £17 10*s.* each. The first term's fee includes uniform and a few other items, and certain necessities in the way of clothing are provided yearly by the institution known as "The Incorporated Thames Nautical Training College", which manages the *Worcester*. A list of requirements is supplied by both ships to the cadet's parents, which are to be regarded as a minimum, and in order to secure uniformity of outfit each ship requires that the outfit be obtained from certain firms with which special arrangements have been made. The *Conway* and *Worcester* receive only those who are intended to become navigating officers, with all the responsibility that the command of a modern steamship implies. Seamanship and navigation are the chief subjects of his studies, but such an exceedingly wide interpretation is given to these terms, and the knowledge of a variety of subjects not strictly coming within those terms is imposed, that the future officer's studies both on board these ships and afterwards should be directed to making him acquainted with many mathematical questions with which the seaman of the old school was not concerned. Queen Victoria instituted a good-conduct prize on these ships, which has been continued by the late King Edward and by King George.

Both these vessels have special facilities with the great steamship companies for aiding the subsequent careers of their pupils. After the boys have put in the necessary two or three years in either, and have passed the examinations on board which are designed to be adequate tests of their knowledge, they are generally apprenticed to the owners of a large and first-class square-rigged ship for three years, the Board of Trade permitting those who have secured the school certificates to spend three years at sea instead of four; though, owing to the steady decline in the number of sailing ships and the increase of the facilities offered by steamship owners of the better class, many of the boys are indentured to steamship owners. The two years' training on either of these vessels is counted as one year towards the four, which are compulsory before the second mate's examination can be taken. This means that the discomfort and drudgery inseparable from a boy's first voyage, if he has not been afloat before, are avoided by this preliminary training, and only three have to be passed at sea. The phrase "years at sea" bears an elastic interpretation; four-fifths of each year must be passed at sea or in a foreign port to which a vessel has gone. Thus an apprentice sailing from the United Kingdom may put in a month or six weeks, or even more, at an Australian port with his vessel, and another month at a South American port, before the ship returns to England, and the whole of the time from her departure until her return is counted as sea service.

The training on the *Conway*, *Worcester*, *Medway*,

Mersey, or *Port Jackson* will have made the way comparatively easy for subsequent study in all the subjects included in the navigational section of the Board of Trade examination for second mate, and a considerable amount of instruction is also imparted under the head of seamanship. The stationary training ships cannot give an actual training in ocean seamanship, but they can and do give a very valuable training in practically all the subjects pertaining thereto. All the stationary training ships attach great importance to boat sailing and boat management, and for their pupils short cruises are arranged in smaller seagoing sailers, so that the actual knowledge which can only be gained by experience is the easier of acquirement when a boy finds himself at sea in a big ship on his first voyage. If he has learnt on a training ship how to go aloft, handle sails, send masts and yards up and down, bend and unbend sails, rowing, boat management, the use of the lead and log and of the rocket apparatus, and the safety regulations, he will find the way comparatively easy. He will have learnt how to use the sextant and other nautical instruments. It will thus be seen that though the two years' preliminary training on a stationary training ship is somewhat expensive, the advantages of the training are very great, and that the expenditure should be incurred if possible.

Sea-going Cadet Ships

When the school-ship examination has been passed and its certificate granted, the future officer may see about becoming apprenticed to a shipowner. Here again means play an important part. If the expense can be met, there is no better course than to apprentice the boy to one of the firms owning the sea-going cadet ships. These firms are Messrs. Devitt & Moore and the White Star Line. The latter company's cadet ship *Mersey* is run essentially in the interests of the White Star and those of its associated lines which are under the British flag. The Union-Castle, the Shaw, Savill & Albion, the Cunard, and the Booth Lines are shareholders in the company known as Messrs. Devitt & Moore's Ocean Training Ships, Ltd., of which Messrs. Devitt & Moore are managers, and this company was formed "with the object of ensuring a supply of efficiently trained officers for their own steamers, and they will give preference to an officer who has served as a midshipman on one of this company's sailing ships". The importance attached to sailing-ship training is shown by the fact that America, Germany, and Belgium have sailing ships devoted to the training of intending officers, and Japan also owns a fine square-rigged vessel, although her ocean-going mercantile marine in the foreign trade consists mostly of steamers. The system of sea training practised on those vessels owes its inception to Lord Brassey, who in 1890 collaborated with Messrs. Devitt & Moore for its establishment on a commercial and practical basis. One of its chief features is that the cadets are not bound by indentures, and are at liberty to withdraw after any voyage. Since the date mentioned, the company's ships have carried about 500 cadets, the highest number at a time being 75, while the average number since the scheme was inaugurated is over 50 per annum. Many of them have risen to be shipmasters and mates on well-known passenger or cargo steamers, and over 50 are in the service of the P. & O. Company. More than 100 have served their four years on the ship before obtaining their certificates as second mates, and many others have completed their time on other sailing ships. For the first voyage the charge is £70, but the charge is decreased with each succeeding voyage. The four consecutive voyages entail a cost of £225, which about covers the cost of training for four years, but not outfit or pocket money. "It will be apparent," say Messrs. Devitt & Moore, "that the cost to a parent or guardian for the training of a boy compares very favourably with the amount expended in preparation for other professions, and, be it remembered, the seagoing cadet is fed, housed, and taught during the greater part of each year." He receives free medical attendance on board, for a fully qualified medical man is carried on each ship. The two present vessels of the company, like the four previously employed in the work, are among the few which are best adapted for continuing the course of instruction imparted on the stationary ships *Conway* and *Worcester*. A boy who has served on either of these ships for two years and has obtained his certificates need only serve three years on the *Port Jackson* or *Medway*, and the reduced terms are offered of £60 for the first voyage, £60 for the second voyage, and £50 for the third voyage. The advantages of combining the courses of training provided by the school ships and those of this company are that, besides receiving the best training available, boys have good expectations of passing their second mate's examination and afterwards of being appointed to one of the lines of steamers associated with the company.

Employment Prospects

In addition to the steamship companies already mentioned, the following steamship lines give a preference to those trained under Messrs. Devitt & Moore: Messrs. Turnbull, Martin, & Co. (The

Scottish Shire Line, Ltd.); Messrs. John Hall, jun., & Co.; Messrs. William Milburn & Co.; The Tyser Line, Ltd.; Messrs. James P. Corry & Co., Ltd. (The Star Line, Ltd.); The Federal Steam Navigation Co., Ltd.; and The Australind Steam Shipping Co., Ltd. Employment on these lines does not prejudice subsequent employment by the mail lines previously mentioned. Another advantage offered by the sea-going cadet ships is that the son of a gentleman may be taught the duties of his profession without being brought into daily contact with so much that is repellent. On many ordinary sailing ships the manners and language of too many of the sailors with whom the apprentices cannot avoid being obliged to associate in their work are exceedingly disagreeable. On the cadet ships the cadets do not associate with the sailors.

The other sea-going cadet ship, the *Mersey*, of the White Star Line, caters for the same classes as the *Conway* and *Worcester* and Messrs. Devitt & Moore's ships. It receives pupils from the two river ships under the same conditions as the other sea-going cadet ships so far as three years at sea instead of four are concerned, and it also takes cadets for four years who have not been to sea before. In the case of the *Mersey*, however, the pupil is indentured for the term he has to serve in order to qualify as second mate. About sixty boys are carried, and preference is given to those who have had a preliminary training on the *Conway* or *Worcester*. The indentures are subject to cancellation if for any reason the managers of the White Star Line should decide to cease running the ship, or the cadets may be transferred to steamers if the managers of the ship desire. The terms are: first year, £70; second year, £60; third year, £40; fourth year, £30; first year from the *Conway* or similar school ship, £60; second year from the *Conway* or similar ship, £40; third year from the *Conway* or similar ship, £30. Cadets who pass the necessary examination and hold an officer's position with one of the associated lines for three years to the satisfaction of the managers have £10 returned to them. On attaining their second mate's certificate they have preference for appointment as junior officers in the steamers of the White Star, Leyland, Dominion, and Atlantic Transport Lines. Promotion is thereafter granted according to conduct and ability. The object of the scheme is that the cadets will remain in the service, passing through the various grades until they obtain their master's square-rigged certificate in accordance with the regulations of the Board of Trade, and they will then be eligible for promotion to be senior officers of the watch. Cadets who join the *Mersey* have what is almost a certainty of employment in one or other of the associated lines, and in this respect are much better off than those who have to depend on chance in obtaining employment after they have secured their certificates.

That many owners, however, do not think that a sailing-ship training is indispensable, is shown by the fact that a number of steamship companies hold out inducements for the training of cadets; the P. & O., in the case of suitable youths, will pay half their fees on board the *Worcester* and then give them special facilities on entering the P. & O. steamers. The number of officers who have had all their training on steamships is steadily increasing.

Training for Boy Sailors

The *Indefatigable*, at Liverpool, was established for the training of boys in poor circumstances who might desire to take up a sea career. A small fee per annum is charged, and the boys are thoroughly taught all branches of seamanship and navigation. Boys from the Liverpool district are received at less charges than those from other parts of the country, but in neither case is the fee a high one. About a quarter of the boys who go to sea from this ship attain certificated rank. In some cases they have worked their way up from before the mast, and in many others they have started as apprentices and, after spending the necessary time at sea, have passed as second mates and been appointed to a position on a ship, usually one sailing from Liverpool, as many Mersey-side firms take a great interest in the ship, and do all they can to further the welfare of the boys. Boys from other than the Liverpool districts have to pay about £22 per annum.

The insufficiency of British sailors for British ships induced the Marine Society and the Shipping Federation to bring out a joint scheme for overcoming the difficulty. The *Warspite*, which is managed by the Marine Society, makes no charge whatever to the relatives of its pupils, but is supported by voluntary contributions, Trinity House, various shipping firms, and some endowments, and receives those boys whose relatives are not in a position to find the means to give them a satisfactory start in a sea life. Only boys of good character are accepted; boys committed to reformatory ships by the magistrates, or sent by Poor Law guardians to be trained for the sea are not received. Since its foundation in 1756 the Society has sent to sea over 66,000 British boys, and it generally has about 240 boys in training. One condition of acceptance for the *Warspite* is that the boy must go to sea. The Society gives him an excellent preliminary training on the

Warspite, provides him with an outfit free, finds him a ship, and takes an interest in his welfare for years afterwards. Some of the boys are placed as apprentices, others go before the mast and either become A.B.'s or work their way up to become certificated officers, and not a few join the Royal Navy. Under the *Warspite*-Federation scheme, the boys nominated by the Shipping Federation will be apprenticed to the Marine Society, and when their half-year's training on the *Warspite* is completed they will be placed on a Federation ship, and their indentures will be transferred to the owner of the vessel. The period of apprenticeship is for such time as is spent on the *Warspite*, in addition to two and a half years at sea. It is hoped that this scheme will help to overcome the difficulty of keeping boys at sea after they have been trained. But, unless the prospects of remunerative employment are increased, it is to be feared that the boys will seek more satisfactory situations ashore, for with the exception of some modern steamships the accommodation for sailors on board ship leaves much to be desired. For many years the Shipping Federation had a system of apprenticeship for boys intending to become A.B.'s, under which the following wages were paid: first year, £7; second year, £8; third year, £10; fourth year, £15; with a bonus of £5 on completion, making, with 1*s.* per month for washing allowance, £42. The Marine Society proposes the following scale of payment without bonus or washing allowance: six months under training, *nil*; first year at sea, £12; second year at sea, £18; last six months at sea, £12; total, £42. The boy will, however, still receive a free kit, and be given preference for employment as an able seaman at the usual rate of wages on the conclusion of his apprenticeship. Several *Warspite* boys have risen by their own efforts to become officers and masters. The Marine Society's scheme is in addition to, and not as a substitute for, that of the Shipping Federation.

Since the *Titanic* disaster, public attention has been directed once more to the question of providing sufficient British seamen for the British mercantile marine. State aid to training ships is one of the remedies proposed to meet the deficiency. As all the institutions afloat and ashore which train boys to become sailors before the mast are—with the exception of the *Exmouth*, founded by the Metropolitan Asylums Board and maintained out of the rates—unable to obtain enough support to allow them to do all the work for which they are equipped, there is much to be said for this scheme. When these ships and shore training schools are filled, it will be time to add to their number, and not at present, when further establishments would only mean keener competition in the appeals to the charitable. The payment of a subsidy to shipowners by the State to take and train boys as seamen on the apprenticeship system is to be recommended. Other good proposals have also been brought forward. Those who compare the prevailing supply with that of fifty years ago forget that the conditions are totally different. It is impossible to teach much seamanship on a vessel that has derricks for masts and no sails. The list of British sailing ships is grievously depleted, and the number is lessened every month. On the average steamer—especially a cargo boat—the boy will become like the rest of the sailors on her, a deck labourer. There is no incentive to him to be anything else. The class of intelligent men who were attracted to the mercantile marine when sailing ships were common shows an increasing tendency to seek employment ashore. The living requirements of all classes have attained a higher level, and until shipowners provide on board their vessels better accommodation for their crews and better food, even than the present scale lays down, and better pay and continuity of employment, all the philanthropic schemes in the world will not keep at sea, at such times as they are in employment, at £4 to £6 a month as A.B.'s, half the boys who are given a start on the water, when they know they can do as well ashore without being severed from their relatives and friends. Thousands of British boys are ready to go to sea if the conditions and prospects are made attractive enough.

Position of Masters

The duties of a master vary so greatly according to the line by which he is employed and the trade in which his vessel is engaged, that it is impossible to lay down any hard-and-fast rules as to the nature of the duties he will be required to perform. It is equally impossible to say what remuneration he will receive.

"The captain on the bridge of any of our great mercantile vessels," says the *Shipping World* (12 May, 1912), "has to prove himself a man of many parts and diverse qualifications. Within recent years his duties have multiplied to a very serious extent, and his responsibilities have correspondingly increased. An entirely new set of problems confronts him nowadays; and whatever may be said to the contrary, we believe they are quite as important, and call for the steady nerve and prompt decision of the master in just as great a degree as the sailing problems of another day. Speed is only one of the many questions before him. Catching the tide is another. Delivering his cargo in time and in condition for its market

is another. Bringing his boat up waterways crowded with moving craft, or up estuaries where considerations of immersion in fresh and salt water are often matters of an inch or two is still another. Conforming to the precise legislative requirements of administrators is another. Signalling in a manner that would astonish any old salt of Nelson's day is another. It is not the size of the vessel that makes all the difference; it is her ingenious mechanism. No longer may her captain harangue his ship's company from the bridge as he might do in the old time, in a moment of danger; he remains to-day a hidden machine, human still, but working with huge and powerful forces of engineering skill to make them do his will, and take the place of many hands who in former days shared the human responsibility in a greater measure than their successors do now."

The pay given in some lines is much lower than a correspondingly expensive training ashore would probably have resulted in, but there has been of late years an improvement in this respect, partly owing to the representations of the Imperial Merchant Service Guild and the Mercantile Marine Service Association, and partly on the initiative of some of the shipowners themselves. The great difficulty with which the organizers of these two societies have had to contend was that the captains and officers as a class were thoroughly disintegrated and isolated, and until their protective societies were formed it was not possible for them to make their influence felt or compel due attention to their representations. Now both these organizations—the Guild especially by reason of its large membership, which embraces more than fifty per cent of the certificated men in the British mercantile marine—have been able to secure several advances in pay for both captains and officers, and there is every reason to believe that more such benefits will shortly follow. The conditions of employment vary so greatly that collective negotiation between the Guild and Association and the owners has not been possible, and it is not to be wondered at that the owners of those important passenger lines who have treated their men well should decline to express any opinion as to the inadequacy of the rates of pay offered by other owners. There are masters going to sea to-day in command of steamships who are receiving £12 per month and even less, and when the arduous nature of the training is considered, together with the expense that has to be incurred, it must be admitted that the prospects of a satisfactory career for them are not good. The officers on those vessels are equally badly paid. Of course both masters and mates are on the lookout for better and more comfortable posts, for on vessels which are run on these parsimonious lines the saving frequently extends to the accommodation and the quality and quantity of the food also.

The conditions of employment are often exceedingly trying. In all the established lines, whether of cargo or passenger steamships, promotion is necessarily slow, and in estimating the business and financial side of a seafaring career this is a circumstance that must be taken into account. Some lines are fairly liberal in the matter of pay to their officers, and, recognizing the slowness of promotion, increase the officers' pay at stated intervals until a maximum has been reached. The rate of pay depends also on the size of the vessel, the trade, and the voyage, and, in the case of passenger vessels, on the social standing of the line. The P. & O., for instance, pays a higher rate all round to its officers than do some of the lines in the trade to the Far East, notwithstanding that the latter may carry some passengers. One outcome of the labour troubles in the shipping industry in 1911 was that the Guild brought prominently before the Shipping Federation the loyalty with which, "in a time of great emergency, the members of the nautical profession stood by their ships and owners". "It was not", says the Guild *Gazette*, "that the captains and officers were not fully in sympathy with the demands of the seamen and firemen for higher pay, but with the former it was at once palpable that they felt it to be the first duty they owed all round to stand firm in their own positions. Accordingly they readily performed exceptional and extraordinary duties, ofttimes at great personal risks, when immense financial losses to the shipowners were thus averted." Ship captains and officers, as a whole, come from social classes to whom the idea of a combination on trade-union lines is repugnant; they have that loyalty to their employers which is the exception among the labouring classes to which the sailors and firemen belong, and they dislike the policy of striking for purely selfish ends, as they know the loss inflicted upon the shipping industry as a whole when ship after ship is held up by a strike. At the same time the sailors and firemen would not have obtained their advance of pay if they had not gone on strike; the shipping industry had been doing well, and the shipowners found it was to their immediate advantage to grant the increase asked for rather than have their ships laid up at great loss. Moreover, seamen and firemen can always obtain situations. Officers, by the nature of their employment, cannot do so; all their positions are carefully recorded, as owners have to take into consideration not only the efficiency of the certificated man, but also the class of vessel

to which by nature and habits he is best fitted to be appointed. Obviously a man who might be an excellent captain of a cattle boat or a collier or tank steamer might find himself in very uncongenial surroundings as captain of one of the favourite passenger liners; and what one would regard as good remuneration the other would not. Each might be as competent, however, as the other as a navigator and seaman. The communication from the Guild to the Shipping Federation set forth a number of suggestions for the Federation to place before its members. It was asked that the Federation should be empowered to give an assurance, as far as possible, that firms of shipowners would always be willing to receive and consider memorials from their masters and officers, either through the medium of the Guild or otherwise. A most important point affecting the welfare of the nautical profession, and sometimes the livelihood of the members, was that a more reasonable attitude should be shown towards shipmasters and officers who had the misfortune to meet with accident to their vessels for which quite probably they were not at fault. There are firms who will not employ any officer under any circumstances who has been on a ship which has met with even a slight accident. It is contended that there are far too many dismissals and resignations demanded without real justification, and that it is a grave hardship that so many masters have been requested to give up their positions when their vessels have been, at the time of the accident, in charge of a compulsory pilot. To those landsmen whose only knowledge of steamships is derived from an inspection of the luxurious quarters provided for the passengers on the new mail liners and the comfortable accommodation given to the officers, it will come as a surprise that the Guild found it necessary to request that masters and officers in all types and classes of ships should be provided with their food when on board, and also with bed and bedding, and that when a ship is in port and food is not provided, at least half a crown a day should be paid as subsistence in addition to the ordinary pay granted.

Rates of Pay

Another representation was that the masters and officers of vessels, whether tank steamers or sailing vessels, carrying oil in bulk or otherwise, or other highly dangerous cargo, should receive 25 per cent more pay in respect to each grade than is paid in vessels carrying ordinary cargoes. The adoption of the three-watch system on all merchant ships was urged, so that no officer should be more than eight hours on duty in every twenty-four except under unusual circumstances. The abolition of Sunday labour in port, unless indispensable, was also asked for. Another important reform proposed was: "That where shipmasters or officers, who are frequently unaware of the fact when sailing from home ports, are compelled to remain trading in waters abroad for some considerable time, they should be entitled to higher pay as compensation for long and enforced absence from home; and that in quarters of the globe such as Australia, New Zealand, or the United States, where definite scales are in vogue, the pay of masters and officers of home ships should correspond". No little dissatisfaction exists that this difference in the rates of pay should be so great. Officers are frequently receiving much less than the men serving under them, and cases have been known in which a second mate has been shipped at an Australian port at higher wages than the first mate was receiving under whom he had to work. It is also urged that great improvements in the accommodation provided for masters and officers of merchant ships should be made, and that every officer should be provided with a separate cabin with sufficient room and adequate equipment in some part of the ship where he can obtain proper rest. The question of reasonable leave without loss of pay was also put forward. These and other representations have resulted in several firms increasing salaries, in some cases directly, and in others by a substantial bonus. Many firms advanced the rates by £1 per month to all grades, and others granted 10*s.* per month all round. The majority of the lines on which the officers are paid by the month give the first officers £12 as a minimum; some pay less, taking advantage of the competition for employment, and £9, 10*s.* per month, recently increased to £10, given by more than one line, is not good pay for a first officer. The officers' wages paid on some of the principal lines, according to the *Merchant Service Guild Gazette* (20 April, 1912), are: Anchor Line, chief officer, £13 monthly, plus £15 12*s.* bonus per annum; second officer, £10, plus £12 bonus per annum; third, £8; fourth, £7. Atlantic Transport Company: chief officer, £16, plus £24 bonus per annum; first officer, £14, plus £18 bonus per annum; second officer, £12, plus £12 bonus per annum (these three officers have in addition a further bonus of £1 per month); third officer, £9 10*s.*, plus 10*s.* bonus per month; fourth officer, £9, plus £1 bonus per month. The Asiatic Steam Navigation Company has added a bonus of approximately £13 6*s.* 8*d.* to the chief and second officers, and advanced the third officer's wages £1 per month. The Federal Line now pays: chief officer, £12, plus £1 bonus the first year, £2 second year, and £3 third year; second officer,

£9, plus similar bonuses; third officer, £7, plus £1 bonus (the bonuses in this line are monthly). Messrs. Lamport & Holt have increased their officers' salaries by granting a monthly bonus, part of which is combined with an insurance scheme: captains, £3 per month bonus; chief officer, £2 monthly bonus; second officer, £1 monthly bonus; third, 10*s.* monthly bonus. New Zealand Shipping Company: chief officer, £14, with bonus; second, £12; third, £9 10*s.*; fourth, £8; fifth, £5. The Prince Line divides its steamers into five classes, viz. those between 3000 and 4500 summer maximum deadweight tonnage, between 4500 and 6500, between 6500 and 7500, between 7500 and 8500, and exceeding 8500. The salaries of the chief, second, and third officers per month for these classes are respectively: £11, £8 10*s.*, and £8; £12, £9, and £8 5*s.*; £12 10*s.*, £10, and £8 10*s.*; £13, £10 10*s.*, and £9; and £13 10*s.*, £11, and £9 10*s.* Additional wages for long service, provided the company considers it satisfactory, are also granted. In addition to these, chief officers of tank steamers when carrying oil will be allowed £1 per month extra; second officer, 10*s.* per month extra; and third officer, 5*s.* per month extra. The Royal Mail Steam Packet Company, which is known as a generous employer, pays on the Brazil route its chief officers £18 12*s.* per month; second officers, £12; third, £9; fourth, £8; fifth, £6. On the transatlantic route the company pays: chief officer, £16; second, £11; third, £9; fourth, £8; fifth, £6. On its intercolonial "Shire" Line of cargo steamers the wages are: chief officers, £15; second, £10; third, £8 10*s.*; fourth, £8.

The wages paid to the masters are usually from 25 to 50 per cent higher than those paid to the chief officers on the same ships, but in the big liner companies the masters receive considerably more, and including navigation money, commissions, bonuses for regularity of voyages, economy of administration of the ship, and other incidental sources, the year's income may amount to £600 or £700, and even more, though there are few steamship commanders nowadays who are making £1000 a year. In comparing these figures with earnings ashore, it must not be forgotten that food and accommodation afloat are provided also. Some firms require their captains to invest in their ship or take shares in the company. At the other end of the scale are to be found masters of good-class passenger steamers paid at the low rate of £20 to £25 per month, while the wages of the masters of some cargo or "tramp" steamers are as low as £12 to £14 per month, and in a few lines the "trip" payment is practised.

Some companies pay weekly. A good example of these is the Great Central Railway Company, which pays the chief officers 50*s.* to 55*s.*, with a 2*s.* rise every two years; and the second officers 40*s.* to 44*s.*, with a 2*s.* rise every two years. A seven days week is usually meant. In some of the weekly lines and coasting services the captains and officers find their own food.

It must be remembered that owners are actuated by a man's record, as, if it be not clean, underwriters in accepting insurances will demand higher rates for any vessel to the command of which he may be appointed. Security of tenure depends upon a clean record, the confidence of employers, and good health and unimpaired ability to pass the official sight test.

The Sight Test

The conditions of the sight test as amended, which will become obligatory in 1914, are not viewed altogether favourably by the majority of shipowners. Some hold that they are too scientific, and that an out-of-door test would be better than the wool test as at present applied. Masters and officers, who have had experience of actual conditions afloat, condemn them. In addition to the Board of Trade sight tests, many of the companies require their masters and officers to be tested periodically as a matter of precaution. The Cunard Line, for instance, requires from all its officers other than captains a test certificate from the Board of Trade every year. When first introduced, four or five years ago, one officer failed and had to resign from the sea. In men who have had lengthy sea experience, the frequent examinations at Liverpool have resulted in a very few elderly men failing in form vision, but none in colour vision. It has therefore been contended that although an older man might not pass the test which a younger man could pass, the older man might be so important to the service by reason of his experience that the question of sight was not the first matter, as a younger man would be responsible for the actual lookout. But in the case of an elderly man employed by a firm which does not take this view, failure in form vision in the proposed compulsory examination of masters means that he may be deprived of his command and be unable to go to sea at all in a certificated position.

Conclusion

To sum up, granted a youth has good health, a sound constitution, normal sight, intelligence, and a taste for roving, has not too ambitious aims in regard to money, and is fortunate in his employers, there are advantages in a sea life which are not to be obtained in any position ashore offering equal financial results.

CHAPTER IV

PASSENGER AND EMIGRANT SHIPS AND FISHING BOATS

Introductory—Passenger Steamers—Emigrant Ships—Passage Brokers—Fishing Boats

INTRODUCTORY

The oversea passengers from the United Kingdom to places outside Europe are about 350,000 inwards and 620,000 outwards annually.

The Continental passengers are about 1,083,000 outwards and 1,115,000 inwards. Of the outward passengers about 56 per cent contract to land at ports within the British Empire.

The ordinary relations of passengers and the carrier, whoever he may be and by whatever means the journey is to be performed, have been noticed elsewhere. (See Part V, Chapter V.)

Carriage of passengers by sea is in many important particulars affected by the Merchant Shipping Act, but apart from special enactment the ordinary rules prevail. The carrier must take due care to carry the passengers safely, and is answerable in damages for his negligence; but there is no absolute warranty of seaworthiness. Breach of positive duty imposed by the Act is subject to penalties as well as private right of action. On the other hand, the passenger may by contract define and limit the terms of carriage.

Injury to a passenger may be due to the negligence of those in charge of his own ship or another or both. In any case he has a remedy against one or both.

Limitation of Liability

The owner of a ship, British or foreign, unless actual fault or privity is shown, is by the Act (1894, sec. 503) liable only to a certain extent for loss of life or personal injury caused to any passenger either in the vessel or another vessel. The limit is an aggregate amount, in the case of loss of life or personal injury, not exceeding £15 for each ton of the ship's tonnage. (See further as to Goods, Chapter VI, of this Part.)

Fault must be proved against each owner; the fault of the master when part owner does not deprive the other owners of the right of limitation.

PASSENGER STEAMERS

"Passenger" includes any person carried in the ship other than the master and crew and the owner, his family and servants.

"Passenger steamer" means every British or foreign steamship, whether originally proceeding from a port in or out of the United Kingdom, except steam ferry boats working in chains, which carries passengers to or from any place or between any places in the United Kingdom. (As to the clause of passenger steamers see further, Chapter V, of this Part.)

Survey

Every passenger steamer which carries more than twelve passengers must be surveyed at least once in each year. The owner or master must obtain a certificate as to survey before the ship plies or goes to sea with passengers on board. In the case

of an emigrant ship which has complied with the provisions as to survey of hull, machinery, and equipment, this is sufficient. The mode of survey is provided by the Act. The shipwright-surveyor and engineer-surveyor furnish declarations to the owner in the required form.

The declaration of the shipwright-surveyor is as to the hull, boats, lifebuoys, lights, signals, compasses, and deck shelter being in accordance with the Act, the time for which and limits within which the hull and equipments will be sufficient, number and division of passengers, and certificates of master and mate.

The engineer-surveyor's certificate speaks as to the machinery, safety valves, fire hose, limit of weight on safety valves, and limit of time for machinery, and the certificates of engineers.

These declarations must be sent by the owner to the Board of Trade within fourteen days. The Board of Trade then, if satisfied, issues a passenger-steamer certificate, with limits as to time and number of passengers in each part. The certificate is transmitted in duplicate to the port superintendent or other public officer.

An owner aggrieved by the declaration of survey or refusal to give a declaration may appeal to the Court of Survey for the port or district, and the judge reports to the Board of Trade.

It has been felt recently that this survey is not sufficiently thorough. In the report on *The Oceana* (1912), the Commissioner referred to the perfunctory inspection of boats; and generally these survey provisions have come in for much criticism. (See also Chapters V and X of this Part.

Certificates

Certificates are not in force for more than one year, and may be cancelled by the Board of Trade for good cause. A duplicate copy of the certificate must be posted by the owner or master in a conspicuous place on board. Penalties are imposed for forging a certificate or declaration. For carrying passengers in excess of the number allowed by the certificate, the owner or master is liable to a penalty of £20 for each offence, and 5*s*. for each passenger so carried. Certificate fees are fixed by the Act.

Certificates may be granted in certain British Dominions and possessions which, under Order in Council, may dispense with the requirement of a Board of Trade certificate.

General Equipment

A sea-going passenger steamer—that is, one which in fact goes to sea—must have her compasses adjusted from time to time to the satisfaction of the shipwright-surveyor and according to the Board of Trade regulations, and be provided with a hose for extinguishing fire connected with the engines. A home-trade passenger steamer must be provided with the required shelter for the protection of deck passengers, if any. Any passenger steamer must be provided with a safety valve on each boiler of a required area and pressure. A fine of £100 is incurred by the owner and £50 by the master if any passenger steamer plies or goes to sea without being so equipped, and a fine of £100 by anyone who increases the weight on the safety valve beyond the limits.

A ship must not carry any passengers on more than one deck below the waterline.

(As to life-saving appliances, boats, &c., see Chapters V and X of this Part.)

Discipline

A fine of 40*s*. is imposed upon any person on a passenger steamer who is drunk and disorderly, molests any passenger, attempts to travel without paying the fare, or commits certain other offences. Such persons may be excluded. Severer penalties are imposed on those who obstruct or endanger any part of the machinery.

The master or other officer and his assistants may arrest without warrant any person offending whose name is unknown.

EMIGRANT SHIPS

An "emigrant ship" is a sea-going ship, whether British or foreign, and whether or not conveying mails, carrying more than fifty steerage passengers, or a greater number of steerage passengers than in the proportion of one statute adult (i.e. a person of at least twelve years or two persons between one and twelve years) to 33 tons of a sailing ship's registered tonnage, or 20 tons of a steamship's.

Steerage passengers are all those except cabin passengers, and cabin passengers are defined according to the space allotted to their exclusive use—a minimum of 36 superficial feet for each statute adult—and the payment of a fare of £25, or 65*s*. for every thousand miles and the supply of a Board of Trade ticket.

Survey

An emigrant sailing ship must not clear out-

wards or proceed to sea until she has been surveyed by two or more competent surveyors, under the direction of the emigration officer at the port of clearance, and has been reported by the surveyors to be seaworthy and fit for her intended voyage. The survey is to be before any cargo is taken on board (except as ballast). The owner may appeal against an adverse report to three other surveyors appointed by the emigration officer.

Equipment

Every emigrant ship, sailing or steam, must be provided with at least three steering compasses, chronometer, fire engine, anchors and cables, lifebuoys (if a foreign ship), and adequate means for night signalling, in each case as required by the Act. The ship must not carry passengers on more than one deck below the waterline, and the number must not exceed the number limited by regulations. Regulations as to number of persons, accommodation for steerage passengers, provisions and water to be supplied to them, carriage of horses, cattle, &c., are prescribed by the Board of Trade. No cargo, luggage or provisions or stores are to be carried on the upper or passenger decks, unless sanctioned by the emigration officer. (As to steamers, see page 29.)

Provisions, &c.

The master must, on the request of any steerage passenger, produce a copy of the scale of provisions, and it must be posted up in the ship. Penalties are imposed for clearing port without the requisite quantities of water and provisions, which must be carried in the mode provided. Medical stores must be carried.

Dangerous Goods

Dangerous goods, such as explosives or unhealthy articles, must not be carried, and horses and cattle only if under proper conditions. The penalty on default is £300.

Carriage of military stores may be authorized by the Secretary of State.

Medical Officer, Staff, and Crew

An emigrant ship must carry a duly qualified medical officer where the number of steerage passengers exceeds fifty, and where the number of persons on board exceeds 300. An emigrant ship carrying 100 steerage passengers must have a steerage steward and, where required, cooks and interpreters, as well as an efficient crew.

There must be a medical inspection of steerage passengers and crew before clearing. Unfit persons must be relanded and their passage money returned.

The crew must be efficient to the satisfaction of the emigration officer, who must give a certificate of clearance. Against his decision of inefficiency there is an appeal to the Board of Trade. The penalty for non-fulfilment of requirements as to crew is for each offence £50.

The master of an emigrant ship must enter into a bond together with the owner or charterer or other sufficient person for £2000, or, where neither the owner nor the charterer resides in the British Islands, £5000, to the Crown. The Board of Trade may allow this to be a continuing bond instead of one made before each voyage.

Penalties are imposed for non-compliance with the provisions as to passenger steamers and for overcrowding.

Passengers' Lists

The master of every ship carrying steerage passengers from the British Islands to any port out of Europe and not within the Mediterranean Sea, or on a colonial voyage, must sign in duplicate a passengers' list, giving names and other particulars of every passenger, the list being countersigned by the emigration officer. To this list must be added any additional passengers taken on board, such an addition being countersigned by the port emigration or customs officer. An emigrant ship for steerage passengers must not clear outwards or proceed to sea till the master has obtained a certificate of clearance, which certifies that all the statutory requirements have been so far complied with, and that the ship is seaworthy. An appeal against a refusal lies to the Board of Trade or to a Court of Survey. Facilities for inspection must be afforded to the officers by the master. A ship proceeding without a certificate is liable to forfeiture.

An emigrant ship which is detained in port after clearance for more than seven days, or puts into or touches at any other port in the British Islands, must not proceed to sea again without replenishing provisions and water and repairing any damage, and the master must obtain a fresh certificate for clearance. The master must report such putting back or calling and its cause to the emigration officer at that port.

Passengers' Contracts

A passenger is entitled to a signed contract ticket in the approved form, and is under a penalty for its non-production on demand, or for

altering, destroying, or inducing any person to part with such a ticket. Any question of breach of such contract may at the passenger's option be tried before a Court of Summary Jurisdiction.

Steerage Passengers—Regulations

Regulations are made with regard to the sanitary conditions and discipline on board. A fine of £2 or imprisonment may be imposed. Spirits must not be sold on board.

The Act also provides for the maintenance of steerage passengers for forty-eight hours after arrival at the end of the voyage in the ship as during the voyage, the return of passage money and compensation of passengers when the passage is not provided according to contract, and for the subsistence of passengers at the expense of any ship in case the ship does not proceed on her voyage without delay as appointed. The payment is stipulated at so much per day.

Penalties are imposed for landing steerage passengers at the wrong place. In case of the wreck of an emigrant ship or damage to the ship necessitating putting back to port, the master or owner must give the emigration officer a written undertaking to re-embark the passengers in another ship within six weeks, or that the damaged ship shall be made seaworthy within the same time. In the meantime the passengers must be lodged and maintained.

Penalties are imposed for carrying an excess number of steerage passengers.

List of Passengers Inwards

There must be a list kept by the master of steerage passengers brought to the British Islands from any port out of Europe and not within the Mediterranean Sea. This must be delivered within twenty-four hours of arrival to the emigration officer. Suitable provision of water and food must be made as in the case of emigration ships proceeding outwards.

Rescue Expenses

The expenses of rescue and conveyance of wrecked passengers from any ship carrying steerage passengers from any port in the British Dominions are defrayed in the first instance wholly or in part by the Secretary of State, Governor, or British Consul. Governors and British Consuls may forward such passengers. Such expenses paid by public officials may be recovered from the owner, charterer, or master of the passenger ship.

Records in the Log

The master of every British ship must enter in the official logbook or keep a record of every occasion on which boat drill is practised on board and on which the life-saving appliances have been examined, and produce such record for inspection. There is not, however, any regulation requiring compulsory boat drill or other practice, which is regarded as a serious omission (see also Chapter VI).

PASSAGE BROKERS

A passage broker within the Act is one who at any place in the British Islands sells or lets, or agrees to sell or let, or is concerned in the selling or letting of steerage passages in any ship proceeding from any place in Europe, not within the Mediterranean Sea.

Passage brokers must enter into a bond with sureties approved by the emigration officer of £1000, and be licensed. Licences are granted after entry into the bond and deposit of security and notice to the Board of Trade, the authority being in London the justices, elsewhere in England the council of the county, borough, or county district, in Scotland the sheriff, and in Ireland the justices. Licences remain in force for thirty-one days after 31 December in each year.

Emigrant Runner

Passage brokers can only employ persons as agents who hold a signed appointment, countersigned by the emigration officer at the nearest port. A list of agents and runners must be exhibited by the passage brokers at their offices, and lists must be supplied to the emigration officers.

If any other person than a licensed passage broker or his *bona-fide* salaried clerk, in or within five miles of the outer boundaries of any port, takes or solicits or recommends any intending emigrant on behalf of any passage broker or owner, charterer, or master of a ship, or other person, in connection with the passage, or gives any information or assistance to any intending emigrant in any way relating to emigration, that person is an emigrant runner. An emigrant runner must be licensed as such by the licensing authority of the port, and will be liable to penalties for acting without being duly licensed and registered, as well as for certain acts of

misconduct. Emigrant runners are entitled to fees from a passage broker only when acting under a written authority, and are liable to penalties for taking or demanding fees from intending emigrants.

Frauds in Procuring Emigration

Any person who by false representation, fraud, or false pretence induces or attempts to induce any person to emigrate or engage a steerage passage in any ship is liable to a fine of £50, or imprisonment for three months. Penalties are also imposed for various other frauds in connection with assisting emigration.

Emigration Officers

These officers and their assistants are appointed in the British Islands by the Board of Trade, and in British possessions by the Governor.

Publication of Provisions of the Act

Abstracts of this part of the Act and of Orders in Council are made by the Board of Trade and supplied to the Customs. The master of every emigrant ship must produce a copy to any steerage passenger, and post copies in two conspicuous places between the decks on which steerage passengers are carried.

FISHING BOATS

A special part of the Merchant Shipping Act, 1894, relates to fishing boats in England and Ireland; partly to

(*a*) All fishing boats and to the whole fishing service; partly to

(*b*) All fishing boats of 25 tons tonnage and upwards; and partly to

(*c*) Fishing boats being trawlers of 25 tons tonnage and upwards, and, where expressly provided, to fishing boats being trawlers of whatever tonnage.

The Board of Trade may exempt any class or extend the provisions to other fishing boats after enquiry.

The general provisions of the Act in respect of master and seamen apply to fishing boats in Scotland whether employed exclusively on the coasts of the United Kingdom or not.

"Fishing boat" here means a vessel of whatever size, and in whatever way propelled, which is for the time being employed in sea fishing or in the sea-fishing service; but unless expressly provided it does not include a vessel used for catching fish other than for profit.

A register of all British fishing boats is kept; and such boats must be lettered and numbered and have official papers.

Before proceeding to sea, a registered fishing boat must be duly provided with boats according to her tonnage, and if carrying more than ten passengers, two lifebuoys and a lifeboat (or one of her boats made buoyant as a lifeboat) kept ready for use. Penalties are imposed in default.

Rules are laid down with regard to discipline, records of death, injuries, ill-treatment, punishments, casualties, &c., and provisions are also made for the settlement of disputes, for ascertaining profits, rendering accounts by owners, and many other matters applying in general to fishing boats.

Special provisions are applicable to fishing boats of 25 tons tonnage and upwards in regard to apprenticeship and agreements with boys; and the provisions applying to trawlers relate to engagement of seamen, payment of wages and discharge, and certificates of skippers and second hands.

Board of Trade regulations may be made respecting the conveyance of fish from trawlers to vessels engaged in collecting and carrying fish to port.

CHAPTER V

PROVISIONS FOR SAFETY

Pilotage—Lighthouses—Towage—Enquiries into Casualties—Safety Provisions—Prevention of Collisions—The *Titanic* Commission and its Recommendations—New Board of Trade Regulations

PILOTAGE

A pilot means any person not belonging to a ship who has the control thereof through a particular part of the voyage. In early times it became customary to grant charters to authorities conferring privileges as to the supply of pilots at various places, and now licensing is general.

Qualified Pilots

A qualified pilot is one licensed by any pilotage authority to conduct ships to which he does not belong. Pilots must be registered by the nearest chief officer of customs, and can act only within the limits of the licensing authority. Pilots must carry the regulations and produce them and their licences to employers and the authorities.

In the ordinary way the employment of an unqualified pilot is subject to a heavy penalty.

In certain cases an unqualified pilot may act, as where no qualified pilot is available or a ship is in distress. He may at any time be superseded by a qualified pilot.

Pilotage Authorities

The expression "Pilotage Authority" includes all bodies or persons authorized to appoint or license pilots, or to fix or alter rates for pilotage, or exercise any jurisdiction in that respect. The Board of Trade may constitute new pilotage authorities when necessary, transfer pilotage jurisdiction, or make further provisions for direct representation of pilots or shipowners on any pilotage authority.

Where pilotage is not compulsory, and there is no restriction on duly qualified persons obtaining licences, the Board may give a pilotage authority power to license pilots and fix rates. The Board of Trade may exempt the master and owners of all ships or classes of ships from the obligation to employ pilots in any district, or from being obliged to pay them when not employed. In all these cases the Board of Trade acts by provisional order, subject to confirmation by Parliament.

By-laws

Pilotage authorities may make by-laws exempting masters of any ships or classes of ships from compulsory pilotage, and as to the qualification of pilots and licensing of pilot boats and conditions of granting licences to pilots and apprentices and pilotage certificates for masters and mates, also for the conduct of pilots and the rates of remuneration, subject to the Act, and in connection with other pilotage matters.

By-laws must be confirmed by Order in Council, and may be appealed against.

Returns

Every pilotage authority must make periodical returns to the Board of Trade as to their by-laws, licensed pilots and apprentices, rates, amounts received, receipts, and expenditure. Failure on the part of any pilotage authority, other than Trinity House or their special Commissioners, to deliver the return within the time fixed, or non-compliance with other requirements, may mean forfeiture of their powers.

Masters' and Mates' Certificates

A pilotage authority may examine the master or mate of any ship as to his capacity to act as pilot for that ship, or other ships of the same owners, and may grant a certificate entitling him to pilot that ship within the limits specified. There is an appeal against a refusal to the Board of Trade, who may, if they think fit, grant the certificate.

Pilot Boats and Signals

All regularly employed boats and ships in the pilotage service must be approved and licensed by the Authority, and distinguished by the name of the owner and port, by certain colours, and by a pilot flag when afloat. The flag must be displayed when the pilot is on board. Certain signals are to be displayed by vessels requiring pilots, and their wrongful display is an offence.

Trinity House

Trinity House is an institution which was incorporated by Henry VIII, and authorized to frame articles in any wise concerning the science or art of mariners. Elizabeth gave further powers to regulate lighthouses and buoys on the English shores and rivers. It has now also the control of pilots.

Trinity House has the power of altering certain regulations, and may appoint sub-commissioners for the examination of pilots. Trinity House may license pilots in the London district, in the English Channel district, and in the Trinity House outports districts, but must not license a pilot to conduct ships both above and below Gravesend. The regulations may be consulted.

Compulsory Pilotage

Subject to alterations made by the Board of Trade or a pilotage authority in pursuance of their powers, the employment of pilots is compulsory in certain districts, with certain exemptions. The master of every ship carrying passengers between any places in the British Isles, within any compulsory pilotage district, must employ a qualified pilot, unless he or his mate holds a certificate. Penalties of double dues may be enforced. The master or owner of any ship passing through any pilotage district on a voyage between two places out of the district is exempt from pilotage.

A pilot who commits an offence, such as defrauding the revenue, misconducting himself, or keeping a public-house, is punishable by fine and forfeiture of licence. A pilot in charge of a ship who, by wilful breach of duty or drunkenness, endangers the ship, or life or limb of any person, is guilty of a misdemeanour, and may be suspended or dismissed by the Authority. There is an appeal from suspension or dismissal to the County Court or Police Court.

There is compulsory pilotage within the London district and the Trinity House outports districts, subject to any alteration made by Trinity House, and a constant supply of pilots is maintained.

Exemptions from compulsory pilotage relate to ships employed in the coasting trade of the United Kingdom, ships of not more than 60 tons, and ships trading from the London district to certain Continental ports and the Channel Islands and others, and ships within the limits of the port or place to which they belong, if there are no special provisions. There are also certain general exemptions in the London and Trinity House outport districts, provided that ships are not carrying passengers between ports in the British Islands.

Pilotage Dues

Pilotage dues for any ship for which the services of a qualified pilot are obtained are payable by the owner or master. As to pilotage inwards, dues are payable by such consignees or agents who have paid or are liable to pay any other charge on account of the ship in the port of her arrival or discharge. As to pilotage outwards, dues are payable by such consignees or agents as have paid or made themselves liable for any other charge on account of the ship in the port from which she clears out. Dues may be recovered in the same manner as fines after a previous written demand. A consignee or agent made liable for pilotage dues may retain the amount and his reasonable expenses from any moneys received on account of the ship and belonging to the owner.

Pilots must not demand or receive, and a master must not offer or pay, improper rates.

The rates of pilotage dues are fixed, but Trinity House may revise these rates. Pilotage dues payable by foreign ships are made to the chief officer of customs at the port of London, and paid over to Trinity House.

A pilot may be entitled to salvage dues if it is clearly shown that he has performed extra services beyond those required from his duty. (See Chapter VIII of this Part.)

A poundage of 6*d*. from the pilotage earnings of all pilots licensed by Trinity House is payable to the Trinity House Pilot Fund, and three guineas each year by every licensed pilot in any district not under the sub-commissioners.

Trinity House Pilot Fund is chargeable in the first place with payment of the expenses of the

duties of Trinity House, and then is administered for the benefit of licensed pilots incapacitated or their dependants. At Hull and Newcastle special sub-commissioners are appointed by the corporations of the Trinity Houses in those ports.

Liability of Owners and Masters

The owner or master of the ship is not answerable to any person whatever for any loss or damage occasioned by the fault or incapacity of any qualified pilot acting in charge of that ship within any district where the employment of a qualified pilot is compulsory, unless under local rules the master is, notwithstanding, left in charge of the navigation. It must be proved that the damage was solely due to the fault or incapacity of a pilot thus compulsorily employed.

LIGHTHOUSES

A lighthouse, in addition to its ordinary meaning, includes any floating or other light exhibited for the guidance of ships, and any sirens or other description of fog signals, or addition to any lighthouse of any improved light, siren, or other fog signal.

Authorities

As a general rule, the superintendence and management of all lighthouses, buoys, and beacons are vested:

In England and Wales and the Channel Islands, adjacent seas and islands, and Gibraltar, in Trinity House;

In Scotland and the adjacent seas and islands and the Isle of Man, in the Commissioners of Northern Lighthouses; and

In Ireland and adjacent seas and islands, in the Commissioners of Irish Lights.

Persons with a local jurisdiction may be entitled to exercise certain rights.

Lighthouse authorities must make returns to the Board of Trade, and the Board, on complaint of insufficiency or improper management, may appoint an inspector. Trinity House and its officers may also inspect any lighthouse.

A lighthouse authority has power to erect or place any lighthouse, and add to, alter, or remove any lighthouse, erect or alter or remove any buoy or beacon, or vary the character of any lighthouse, with the incidental powers necessary to carry these objects into effect.

The Commissioners of Northern Lighthouses and of Irish Lights must submit a scheme to Trinity House and obtain the sanction of the Board of Trade before exercising their powers. Trinity House, with the sanction of the Board of Trade, may direct these two Lighthouse Authorities as to works to be done.

Light Dues

A general lighthouse authority levies dues payable in respect of all ships, except those belonging to the King and others exempted. The scale may be revised by Order in Council. Tables of light dues must be posted at all Customs houses. Light dues are levied with respect to the voyages made by ships or by way of periodical payment, and no longer with respect to the lights passed. The scale is provided by the Act of 1898, but may be varied by Order in Council. Persons liable in respect of any ship are the owner or master or the consignees or agents who have paid or made themselves liable to pay any other charge on account of the ship at the port of her arrival or discharge. A ship may be distrained upon in default.

All light dues are credited to the General Lighthouse Fund.

Local Lighthouses

Lighthouses under any local management are inspected by the general lighthouse authorities, who, with the sanction of the Board of Trade, have control over any local lighthouse authority.

Local light dues must be applied by the Authority for the purpose of construction and maintenance and improvement of the lighthouses, buoys, and beacons.

Expenses of General Lighthouse Authorities

These are met out of the General Lighthouse Fund, establishments being fixed by Order in Council. Estimates of accounts of expenses must be sent to the Board of Trade for approval. For the purposes of construction and repair, the Treasury may make advances. The Lighthouse Fund may be mortgaged by the Board of Trade.

Offences

Wilful or negligent injury to any lighthouse or lights, buoy or beacon, removal, alteration,

obstruction, or other injury, is an offence subject to a fine of £50.

False lights may be put down by a lighthouse authority after giving notice for removal. Failure to comply with the notice is an offence subject to a fine of £100.

Special Jurisdiction

In the Channel Islands the powers of Trinity House must not be exercised without the consent of His Majesty in Council, nor dues collected without the consent of the States of those islands.

In any British possession, with the consent of the local legislature, lighthouse dues may be fixed by Order in Council.

Application of Funds

All fees, charges, and expenses payable in respect of survey, fees received by the Board of Trade and other authorities other than fines and forfeitures, and the general revenue resulting from the administration of the Act (except such dues as are payable to the General Lighthouse Fund), are paid into the Exchequer. All salaries, expenses, superannuation allowances, claims, pensions, costs, and expenses are paid out of moneys provided by Parliament, and the accounts after audit are laid before Parliament.

TOWAGE

Towage is a contract by which one vessel is employed to expedite the voyage of another, and is somewhat similar to salvage. (See Chapter VIII of this Part.)

The employment of a steam vessel as a tug for towage is a contract implying risk both to the tug and the tow. There is no implied warranty to bring the ship to its destination at all hazards. In case of a collision between a tug and another vessel, if not actually in fault the tow is not liable, as a barge in tow has a right to expect that the tug will be carefully navigated.

ENQUIRIES INTO CASUALTIES

With the object of avoiding disaster at sea, the law has not only made certain safety regulations, but has provided that a searching enquiry shall be held into casualties which have occurred.

Where a shipping casualty has occurred, a preliminary enquiry may be held by the inspecting officer of the coastguard, or chief officer of customs near the coast of the United Kingdom where it occurs, or elsewhere by such officer near any place where witnesses arrive or are found or can be conveniently examined, or in any case by any person appointed by the Board of Trade.

Where such a person, after a preliminary enquiry, thinks a formal investigation should be held, or the Board of Trade directs one, a Court of Summary Jurisdiction may hold such an investigation; or a Wreck Commissioner may hold an investigation on request of the Board of Trade. The Court has the assistance of assessors, and makes a report to the Board of Trade. The Board of Trade may cause an enquiry to be held in the case of loss of life from any fishing vessel's boat. The Board of Trade may suspend or cancel the certificate of any master, mate, or engineer convicted of any offence, and such a certificate may be cancelled or suspended by any Court competent to hold a formal investigation into a casualty or an enquiry into the conduct of a master, mate, or engineer, acting under the powers of the Act. The Board of Trade may cause an enquiry to be held as to the conduct of a certificated officer. Admiralty Courts may remove the master of any ship. The Board of Trade may order a case to be re-heard if new or important evidence comes to light or there is a suspicion of a miscarriage of justice. In certain cases Colonial Courts may enquire into casualties and the conduct of officers.

A Naval Court may be summoned by any officer in command of any of H.M. ships at a foreign station, or in his absence by a consular officer, and consists of from three to five members. Such a Court hears any complaint or investigates any wreck, abandonment, or loss. A Naval Court has power to remove the master or cancel or suspend certificates, discharge seamen, order payment of wages, and decide disputes and award costs and punishments. The Court may send a prisoner to the United Kingdom or to a British possession.

Every Naval Court must make a full report to the Board of Trade.

SAFETY PROVISIONS

Seaworthy Ships

Any person sending or attempting to send, or party to the sending of or attempting to send, a British ship to sea in such an unseaworthy state that the life of any person is likely to be thereby endangered, is guilty of a misdemeanour, unless he proves that he used all reasonable means to ensure her being sent to sea in a seaworthy state, or that her going to sea in an unseaworthy state was under the circumstances reasonable and justifiable. The master of such a British ship knowingly taking her to sea in such an unseaworthy state is guilty of a misdemeanour, unless he proves that under the circumstances it was reasonable and justifiable. This does not apply to any ship employed exclusively in trading, or going from place to place, on any British river or inland water.

Notwithstanding any agreement to the contrary, there is an implied obligation in every agreement of service that the owner and the master and every agent charged with loading or preparing or sending the ship to sea will use all reasonable means to ensure the seaworthiness of the vessel at the time the voyage commences, and keep her in a seaworthy condition during the voyage. (See Chapter III of this Part.) An unsafe ship either by reason of defective condition of hull, equipment, machinery, or undermanning, may be detained by the authorities.

In any proceedings against any seaman or apprentice for desertion or absence without leave, if a certain proportion of the seamen allege that the ship was not in a fit condition to proceed, or had insufficient accommodation, the Court may have a ship surveyed.

Courts of Survey

A Court of Survey for a port or district consists of a judge and two assessors. The judge is summoned for the purpose out of a list, approved by the Secretary of State, of Wreck Commissioners, stipendiary or metropolitan police magistrates, County Court judges or other fit persons, or may be a special Wreck Commissioner. Assessors are persons of nautical, engineering, or other special skill and experience summoned out of a list of persons periodically approved by a local marine board, or board of local shipowners or merchants, or appointed by the judge. Wreck Commissioners are appointed by the Lord Chancellor. There are not to be more than three at any one time.

A Court of Survey hears every case in open Court, acting under general rules.

In cases of construction or scientific difficulty, the Board of Trade may refer a question to scientific referees.

Draught of Water

The Board of Trade may direct any person appointed by them to record the draught of water of any sea-going ship, as shown on the scale of feet on her stem and stern, and the extent of her clear side in feet and inches, upon her leaving any dock, wharf, port, or harbour and proceeding to sea. The master of every British sea-going ship upon so leaving must record her draught of water and the extent of her clear side in the official log-book, and produce the record when demanded.

"Clear side" means the height from the water to the upper side of the plank of the deck from which the depth of hold as stated in the register is measured, and the measurement of the clear side is to be taken at the lowest part of the side.

Marking of Load Lines

Every British ship, and foreign ships while within any port in the United Kingdom, except sailing ships under 80 tons register employed solely in the coasting trade, fishing and pleasure yachts, or ships employed exclusively in trading or going from place to place in any river or inland water in British possessions, must be permanently and conspicuously marked with deck lines of required size and position. The owner of every such ship must mark upon each of her sides amidships a circular disc of the required colour, 12 in. in diameter, with a horizontal line of 18 in. through its centre. The centre of the disc, placed on a level approved by the Board of Trade below the deck line, indicates the maximum load line, the "Plimsoll mark", to which it is lawful to load the ship. Ships with the centre of the disc submerged are deemed unsafe, and will be detained.

The times for marking the load line are stipulated by the Act in the case of foreign-going vessels and coasting vessels, and penalties are imposed for failure to mark and for concealing, altering, or obliterating a mark. The Board of Trade appoint the Committee of Lloyd's Register or any other such corporation or association or officer of the Board of Trade to approve and certify the position of any disc indicating the load line, and make regulations as to load lines. The provisions

of a Colonial Legislature with respect to load lines may be declared by Order in Council and have the same effect; and the Board of Trade may certify that regulations of a foreign country may be effective also.

The Act contains special restrictions on the carriage of dangerous goods. (See Chapter VI of this Part.)

Provisions controlling the loading of timber as deck cargo are contained in the Acts of 1894 and 1906, and for the carriage of grain in the Act of 1894. (See Chapter VI of this Part.)

Equipment and Provisions for Safety

Every British sea-going steamship, if employed to carry passengers, must have her compasses properly adjusted from time to time, and every British sea-going steamship not used wholly as a tug must have fire hose connected with her engines. Penalties are imposed in default, and also upon any person who places undue weight on the safety valve.

Signals of distress must be used or displayed only in the case of actual need, and a sea-going passenger steamer or emigrant ship must be provided with signals of distress and proper supply of inextinguishable lights for attachment to life-buoys. Life-saving appliances must be carried, having regard to the nature of the service on which the ship is employed. A surveyor of ships may inspect for this purpose. The provisions may be applied to foreign ships in British ports. Anchors and chain cables must be tested in accordance with regulations.

Wireless Telegraphy

Wireless telegraphy has revolutionized communication with vessels at sea, and substituted, as far as regards ships which are installed with this apparatus, other distress signals. The distress signal is S.O.S. or C.Q.D.

The International Conference on Wireless Telegraphy, which concluded its sittings in July, 1912, considered the use of wireless telegraphy for the prevention of disasters at sea, and passed a unanimous resolution in favour of the principle of compulsory equipment of ships in the general interests of navigation; this to be brought about by international agreement. The Conference also recommended the establishment in each maritime country of a number of coast stations with a permanent service adequate to the needs of navigation. New regulations to render the use of wireless telegraphy at sea more effective were passed. Ships are to be required to provide an auxiliary source of power able to work the wireless apparatus for at least six hours. This installation is to be placed in as secure a position as possible, and must be entirely self-contained, so that an accident to the ship which stops the working of the ship's engines need not affect the wireless apparatus. On ships of the first class a permanent watch by two fully qualified wireless operators must be maintained, and on ships of the second class an operator is required to listen during the first ten minutes of every hour. In small ships, fishing boats, &c., no regular period is prescribed. The Government will determine the classification.

Both ship and shore stations are to suspend work and listen at the end of each quarter of an hour in cases where it is likely that distress calls might not otherwise be heard. A ship in distress is to have control over the wireless working of all stations in its vicinity; the wireless operators on board being placed under the control of the captain.

Other regulations facilitating communication with the shore by transmission of radio-telegrams by intermediate ships and intercommunication between ships were agreed to by the Conference.

PREVENTION OF COLLISIONS

Regulations applying to all foreign ships while they are within British jurisdiction, as well as to British ships, are made by Order in Council on the recommendation of the Admiralty and the Board of Trade for the prevention of collisions at sea. These regulations deal with distinctive lights and colours for various classes of ships, fog signals and speed in fog, steerage and sailing rules, signals for a vessel in sight of another, distress signals, &c.

Owners and masters of ships must obey the regulations, and not carry or exhibit any other lights, or use any other fog signals than those prescribed, non-observance being a misdemeanour. Surveyors of ships may inspect any ship for the purpose of seeing the provision of lights and fog signals.

In every case of collision between two vessels it is the duty of the master or person in charge of each vessel, so far as he can without danger to his own vessel, crew, or passengers, to render the other vessel such assistance as may be practicable and necessary, and to stay by until further assistance is not needed, and also to give the master or

person in charge of the other vessel the name and port of his own vessel, and the names of the ports from which she has come and to which she is bound; but failure of the master to stand by is no longer a presumption that the collision was due to his wrongful act or neglect or default. Failure to comply with any of these requirements is a misdemeanour.

Wherever practicable, the master must immediately after the occurrence enter a statement of any collision and the circumstances in the official log-book, the entry to be signed by the master and by the mate or one of the crew.

By agreements with foreign countries, these collision regulations may be made applicable to foreign ships outside British jurisdiction. (See also Chapter X of this Part.)

Report of Accidents

When a steamship has sustained any accident occasioning loss of life or serious injury to any person, or material damage affecting her seaworthiness or efficiency, it must be reported by the owner or master within twenty-four hours, or as soon after as possible, to the Board of Trade. The managing owner or the ship's husband of any British ship must report to the Board of Trade, in writing, the loss or feared loss of any British ship.

THE *TITANIC* COMMISSION AND ITS RECOMMENDATIONS

The enquiry by the Wreck Commissioner into the loss of the *Titanic* in April, 1912, was the most important enquiry of this nature that has been held, and its findings are entitled to the utmost consideration both in their bearings upon the actual requirements of the law and the regulations and administration of the Board of Trade. The peculiar facts of the case affecting that vessel's navigation, of the greatest public interest at the time, do not concern us here. The wreck was due to collision with an iceberg brought about through navigation at excessive speed, but the captain was not found to have been negligent, as hitherto such navigation in ice had not been considered dangerous.

The specially appointed Wreck Commissioner was Lord Mersey of Toxteth, better known as Mr. Justice Bigham, who was for a short time President of the Probate, Divorce, and Admiralty Division of the High Court, and who while at the Bar had a wide experience of commercial and shipping cases. Five assessors sat with the Commissioner: Rear-Admiral the Hon. S. A. Gough-Calthorpe, Captain A. W. Clarke, Commander F. C. A. Lyon, Professor J. H. Biles, D.Sc., LL.D., and Mr. E. C. Chaston, R.N.R.

The Court held thirty-seven public sittings, and the Report was issued on 30 July, 1912.

It has been remarked that every great maritime disaster has been followed by an increase in knowledge and improvement in practice which have secured greater safety and improved design and construction. This may be expected to be peculiarly true in regard to the *Titanic*. The Marine Department of the Board of Trade has always endeavoured to improve upon the condition of things actually required by the Merchant Shipping Acts, and ships have generally been equipped (as in the case of the *Titanic's* boats) beyond the legal requirements. Without waiting for this Report or new regulations, many shipping companies expressed the intention of providing boat accommodation for every passenger. While the Report failed to find any justification for the alleged want of due care in the supervision of the Board of Trade, the Commissioner was not satisfied with the explanations offered in excuse of the delay in revising the rules and regulations made so long ago as 1894.

Perhaps the most noticeable recommendation was that which would disregard what had been till that time a matter of international acceptance, viz. that when ships are divided into efficient water-tight compartments, boat equipment and other life-saving appliances may be proportionately reduced. While recommending an improved division into water-tight bulkheads, the Court was not of opinion that boat equipment could be regarded as a subordinate matter.

The Recommendations of the Court

Water-tight Subdivision.—That the newly appointed Bulkhead Committee should enquire and report, among other matters, on the desirability and practicability of providing ships with (*a*) a double skin carried up above the waterline; or, as an alternative, with (*b*) a longitudinal, vertical, water-tight bulkhead on each side of the ship, extending as far forward and aft as convenient; or (*c*) with a combination of (*a*) and (*b*). Any one of the three (*a*), (*b*), and (*c*) to be in addition to water-tight transverse bulkheads.

That the Committee should also enquire and report as to the desirability and practicability of fitting ships with (*a*) a deck or decks at a convenient distance or distances above the waterline

which shall be water-tight throughout a part or the whole of the ship's length; and should in this connection report upon (*b*) the means by which the necessary openings in such deck or decks should be made water-tight, whether by water-tight doors or water-tight trunks, or by any other and what means.

That the Committee should consider and report generally on the practicability of increasing the protection given by subdivision; the object being to secure that the ship shall remain afloat with the greatest practicable proportion of her length in free communication with the sea.

That when the Committee has reported upon the matters before mentioned, the Board of Trade should take the report into their consideration and, to the extent to which they approve of it, should seek statutory powers to enforce it in all newly-built ships, but with a discretion to relax the requirements in special cases where it may seem right to them to do so.

That the Board of Trade should be empowered by the Legislature to require the production of the designs and specifications of all ships in their early stages of construction, and to direct such amendments of the same as may be thought necessary and practicable for the safety of life at sea in ships. (This should apply to all passenger-carrying ships.)

Lifeboats and Rafts.—That the provision of lifeboat *and raft* accommodation on board such ships should be based on the number of persons intended to be carried in the ship and not upon tonnage.

That the question of such accommodation should be treated independently of the question of the subdivision of the ship into water-tight compartments. (This would involve the abolition of Rule 12 of the Life Saving Appliances Rules of 1902, which is to the following effect:—"When ships of any class are divided into efficient water-tight compartments, to the satisfaction of the Board of Trade, they shall only be required to carry additional boats, rafts, and buoyant apparatus of one-half of the capacity required by these rules, but the exemption shall not extend to life-jackets or similar approved articles of equal buoyancy suitable to be worn on the person.")

That the accommodation should be sufficient for all persons on board, with, however, the qualification that in special cases where, in the opinion of the Board of Trade, such provision is impracticable, the requirement may be modified as the Board may think right. (In order to give effect to this recommendation, changes may be necessary in the sizes and types of boats to be carried and in the method of stowing and floating them. It may also be necessary to set apart one or more of the boat decks exclusively for carrying boats and drilling the crew, and to consider the distribution of decks in relation to the passengers' quarters.)

That all boats should be fitted with a protective, continuous fender, to lessen the risk of damage when being lowered in a seaway.

That the Board of Trade should be empowered to direct that one or more of the boats be fitted with some form of mechanical propulsion. (This is permissible but not compulsory under the Regulations of 1910.)

That there should be a Board of Trade regulation requiring all boat equipment (under sections 5 and 6, page 15 of the Rules, dated February, 1902, made by the Board of Trade, and requiring the equipment of boats with oars and appliances for navigation, lamps, &c.) to be in the boats as soon as the ship leaves harbour. The sections quoted above should be amended so as to provide also that all boats and rafts should carry lamps and pyrotechnic lights for purposes of signalling. All boats should be provided with compasses and provisions, and should be very distinctly marked in such a way as to indicate plainly the number of adult persons each boat can carry when being lowered.

That the Board of Trade inspection of boats and life-saving appliances should be of a more searching character than hitherto. (This and other recommendations bear out the Report on the *Oceana*. See page 29.)

Manning the Boats and Boat Drills.—That in cases where the deck hands are not sufficient to man the boats, enough other members of the crew should be men trained in boat work to make up the deficiency. These men should be required to pass a test in boat work.

That in view of the necessity of having on board men trained in boat work, steps should be taken to encourage the training of boys for the Merchant Service. (See Chapter III of this Part.)

That the operation of section 115 and section 134 (a) of the Merchant Shipping Act, 1894 (relating to agreements with and wages of the crew), should be examined, with a view to amending the same so as to secure greater continuity of service than hitherto.

That the men who are to man the boats should have more frequent drills than hitherto. That in all ships a boat drill, a fire drill, and a water-tight door drill should be held as soon as possible after leaving the original port of departure and at convenient intervals of not less than once a week during the voyage. Such drills to be recorded in the official log.

That the Board of Trade should be satisfied in

BRITAIN
CANADA
COMMONWEALTH OF AUSTRALIA
HOLLAND
BELGIUM
DENMARK
ITALY
AUSTRIA - HUNGARY
SWEDEN
TURKEY
MONTENEGRO
PERSIA
MEXICO
COSTA RICA
HONDURAS
ORDEM E PROGRESSO
ARGENTINE REPUBLIC
BRAZIL
CHILI
ECUADOR
URUGUAY
PARAGUAY

UNION OF S. AFRICA
FRANCE
GERMANY
NORWAY
SPAIN
PORTUGAL
ROUMANIA
BULGARIA
GREECE
CHINA
JAPAN
UNITED STATES
GUATEMALA
NICARAGUA
SAN SALVADOR
VENEZUELA
BOLIVIA
PERU
LIBERIA
TUNIS
EGYPT

each case before the ship leaves port that a scheme has been devised and communicated to each officer of the ship for securing an efficient working of the boats.

General Recommendations. — That every man taking a lookout in such ships should undergo a sight test at reasonable intervals.

That in all such ships a police system should be organized so as to secure obedience to orders, and proper control and guidance of all on board in times of emergency.

That in all such ships there should be an installation of wireless telegraphy, and that such installation should be worked with a sufficient number of trained operators to secure a continuous service by night and day. In this connection regard should be had to the resolutions of the International Conference on Wireless Telegraphy (see page 38). That where practicable a silent chamber for "receiving" messages should form part of the installation.

That instruction should be given in all Steamship Companies' Regulations that, when ice is reported in or near the track, the ship should proceed in the dark hours at a moderate speed or alter her course so as to go well clear of the danger zone.

That the attention of masters of vessels should be drawn by the Board of Trade to the effect that under the Maritime Conventions Act, 1911, it is a misdemeanour not to go to the relief of a vessel in distress when possible to do so. (This was done.)

That the same protection as to the safety of life in the event of casualty which is afforded to emigrant ships by means of supervision and inspection should be extended to all foreign-going passenger ships. (See page 30.)

International Conference. — The Report concluded with what is clearly the most needed factor in any comprehensive scheme of improved conditions of safety at sea. It was recommended that (unless already done) steps should be taken to call an International Conference to consider, and as far as possible to agree upon, a common line of conduct in respect of (*a*) the subdivision of ships; (*b*) the provision and working of life-saving appliances; (*c*) the installation of wireless telegraphy and the method of working the same; (*d*) the reduction of speed or the alteration of course in the vicinity of ice, and (*e*) the use of searchlights.

NEW BOARD OF TRADE REGULATIONS

The Merchant Shipping Advisory Committee presented a Report (Cd. 6353) to the Board of Trade, which was issued shortly after Lord Mersey's Report on the *Titanic* disaster. The Report was unanimous, but some of the members made important reservations (see also Chapter X of this Part). The Committee gave figures which showed that since the introduction of the existing Life Saving Regulations there had, notwithstanding a great increase in the number of lives carried, been a marked diminution in the loss of life at sea. This marked diminution in loss of life had resulted mainly, if not entirely, from the prevention of casualties necessitating recourse to the boats and other life-saving appliances, and not from the succour afforded by such appliances after such disasters had taken place. With the exception of possibly one case, there was no evidence of any life having been lost owing to the lack of boat accommodation since the introduction of the existing Life Saving Regulations.

They regarded the *Titanic* as a vessel belonging to a special and limited class of passenger vessel, and its equipment could have little relation to that of cargo vessels; and the circumstances in that case had demonstrated the extraordinary difficulty, even in calm weather, of using to the full on a passenger vessel carrying large numbers the boat accommodation already provided. "We are satisfied that it is by proceeding on these lines (viz. taking precautions for the buoyancy of the vessel after the casualty and for communication with the shore and other vessels) that the safety of the passengers can be best secured."

The Committee made many other important recommendations, which were, where possible, followed in the new Board of Trade Draft Rules issued shortly after (Cd. 6402). These Rules took both Reports into consideration, but it was pointed out that some matters must wait for further legislation (e.g. boat drill and manning of boats), and others for international agreement (e.g. wireless telegraphy and speed in the region of ice). The new regulations met with much criticism, especially from shipowners (see also Chapter X of this Part), in regard to the provision of boats.

The following were the principal draft Regulations:—

Foreign-going Ships

1. Foreign-going passenger steamers, emigrant ships, and foreign-going sailing ships carrying passengers are in future to provide *sufficient lifeboat accommodation for all on board.*

2. The number of boats to be attached to davits

is no longer to depend on tonnage, but on the length of the ship; and the davits must be placed amidships.

This Rule is subject to modifications where, in the opinion of the Board of Trade, it is not practicable to provide for the number of sets of davits required either in respect of an existing ship or of a future ship; and a ship will not be required to carry a larger number of sets of davits than is sufficient to provide lifeboats for all on board.

3. Appliances or arrangements at least as effective for launching boats may be substituted for davits. Where the boat deck is of excessive height above the water the ship may be required to carry davits or some other form of launching appliances.

4. Lifeboats must be of a prescribed build. "Lifeboat" includes the "decked lifeboat", but not a collapsible boat. Existing collapsible boats are, however, allowed to count for a certain period.

5. Changes in the type and construction, rules, and method of ascertaining strength and carrying capacity.

6. A larger proportion of motor boats is to be allowed.

7. Lifeboats to be fitted with protective fenders. Their equipment somewhat enlarged; every boat to carry the prescribed equipment.

8. All life-jackets and lifebuoys are to be suitably placed, and their position plainly indicated. At least half the lifebuoys must have ignition apparatus attached.

9. The existing General Rule 12 (providing that a lesser number of boats might be provided in the event of the ship being divided into efficient watertight compartments) is abrogated.

10. Foreign-going cargo steamships, which were under existing rules required to carry on each side boats (of which one must be a lifeboat) sufficient to accommodate all persons on board, were to carry sufficient lifeboats, fully equipped, on each side to accommodate all on board. Foreign-going cargo sailing ships must carry sufficient and fully equipped lifeboats for all on board.

Home Trade Vessels

Home trade passenger ships, including cross-Channel and excursion vessels, can carry safely and conveniently in many cases considerably greater numbers in proportion to the size of the vessel than in the case of a foreign-going ship.

To impose an obligation on these home trade vessels to carry lifeboats based on the maximum number for which the vessel is certified was recognized to demand what is physically impracticable. To provide boats and buoyant apparatus, buoyant deck seats, and the like (apart from life-jackets), would also be in many cases impracticable, especially in the case of the excursion steamers.

In considering these classes of ships it was thought reasonable to take into account the limitation of their voyages and the conditions under which the voyages are undertaken.

The principles on which these Rules deal with home trade passenger ships are:—

Buoyant apparatus (such as life-rafts, buoyant deck seats, &c.) is recognized as an integral part of the provision as well as lifeboats.

Lifeboats and buoyant apparatus (other than life-jackets) are required to be provided sufficient for all persons allowed to be carried by any ship under a passenger certificate which is applicable to any voyage outside partially smooth waters, other than a short voyage limited to daylight hours in the summer months or on certain specified days.

In the case of voyages limited to daylight hours in summer, or to smooth or partially smooth waters, the requirements as to lifeboats and buoyant apparatus (other than life-jackets) are suitably reduced.

Life-jackets are required to be carried for all persons on board in addition to, and not in substitution for, any other life-saving appliances.

As regards existing ships, the new requirements as to the provision of lifeboats and buoyant apparatus might, if necessary, be reduced; and in the case of the limited voyages, a lower scale of requirements was temporarily applied to existing ships.

Classes of Passenger Steamers

Home trade passenger steamers were under the regulations divided into six classes — Classes I, V–IX.

Classes I and V (No. 2 Certificate) include cross-Channel (Continental) boats, and passenger steamships plying along the coast, or between Great Britain and Ireland or the Isle of Man. These two classes are dealt with on the same basis.

The old regulations required, according to tonnage, a certain number of boats under davits, and additional boats or buoyant apparatus (other than life-jackets). The number of lifeboats under davits was made proportioned to the length of the vessel; and the lifeboats must reach a certain minimum aggregate cubic capacity. The boats must always be kept fully equipped.

As regards the total number of persons for whom boats and buoyant apparatus must be carried, it was provided that there might be two certificates for this class of vessel—

(*a*) An ordinary passenger certificate authorizing a certain number of persons (crew and passengers) to be carried in the vessel by night or day, all the year round and in all weathers.

(*b*) A special passenger certificate which, when the vessel is engaged upon short daylight voyages, during the summer months or on certain specified days (not exceeding six) in the year, would entitle her to carry persons in excess of the total number of persons allowed by the ordinary certificate.

These vessels would be required to carry lifeboats and rafts, deck seats, and buoyant apparatus (other than life-jackets), sufficient for the full number of persons for which the vessel was certified under the ordinary certificate.

When a special certificate is granted, sufficient lifeboats and rafts, deck seats, and buoyant apparatus (other than life-jackets) must be carried to provide accommodation for 80 per cent of the number allowed by the special certificate, or for the total number of persons allowed by the ordinary certificate, whichever number is the greater.

In all cases sufficient life-jackets must be carried for all on board, in addition to the buoyant apparatus, together with lifebuoys.

Class VI (No. 3 Certificate).—These steamers are limited by their certificates to short excursions to sea along the coast beyond partially smooth-water limits, which must be in fine weather, by daylight, and in the best part of the year. These vessels are to carry two lifeboats if under, and four lifeboats if over, 200 ft. in length, all attached to davits. They must carry also buoyant apparatus (other than life-jackets) sufficient, with the boats, to provide for 70 per cent of the number for which the vessel is certified.

In all cases sufficient life-jackets must be carried for all on board, in addition to the buoyant apparatus, together with lifebuoys.

Classes VII, VIII, IX.—The remaining classes of home trade passenger vessels do not go far from the shore or bank, and ply—(*a*) In partially smooth water (Class VII, Certificate No. 4); (*b*) in smooth water in estuaries and lakes (Class VIII, Certificate No. 5); (*c*) in rivers, canals, and small lakes (Class IX, Certificate No. 5).

There must be enough life-jackets for all on board.

Home Trade Passenger Certificates.—In each of the classes above mentioned the number of persons which a ship is at present allowed by the passenger certificate to carry can be reduced if the owner desires.

Classes X, XI, XII, XIII include steam launches, motor boats, tugs, fish carriers, dredgers, &c.

In addition to the boats and the buoyant apparatus required for each class, sufficient life-jackets for the whole number of persons for which the boat is certified must be carried, as well as a proportionate number of lifebuoys.

In the case of existing ships, some of the regulations were temporarily suspended or might be relaxed by the Board of Trade.

Home Trade Cargo Vessels.—In home trade cargo steamers (except coasting vessels) which were before required to carry on each side boats (of which one must be a lifeboat) to accommodate all persons on board, all the boats, except one, must be lifeboats, and fully equipped. As regards home trade sailing ships, the requirements were altered so as to ensure that all the boats should be lifeboats. In every case the vessel must carry sufficient lifeboats for all on board.

General Rules.—The changes in the General Rules under the heading of foreign-going ships were made to apply, with one or two exceptions, to home trade vessels.

Operation of Rules

The Rules (subject to the sanction of Parliament) were made to come into force on 1 January, 1913, but not to apply to passenger steamers so far as they involve structural alterations to the ship until the lapse of any passenger certificate valid on 1 October, 1912, i.e. until the vessel came up for its annual survey.

CHAPTER VI

THE CONTRACT OF AFFREIGHTMENT

Introductory—Carriers by Sea—Carriage in a General Ship—Carriage by Charter-party—Construction of the Contract—Non-performance.

INTRODUCTORY

The contract of affreightment is the contract for the carriage of goods in vessels, and is usually made either by bill of lading or charter-party. Freight is the amount payable for the carriage. When goods are shipped in a general ship, along with cargo belonging to other shippers, the contract is generally contained in a bill of lading. When the whole or the principal portion of the ship is engaged by a charterer, the contract is by charter-party. The former is the most common instance of carriage by sea, and the modern tendency in the shipping world is towards consolidation of shipping laws and a form of contract which is more or less in use by all shipowners, with adaptations to the particular class of cargo carried. General considerations with regard to carriage by sea must first be considered in this chapter.

CARRIERS BY SEA

Carriers both by land and sea holding themselves out to receive and carry goods for reward are responsible for the safe delivery of the goods, subject to certain exceptions. (See also Part V, Chapter V.) With regard to sea carriage, these exceptions are: the act of God, the King's Enemies, some fault in the goods themselves apart from the method of carriage or stowage, goods properly jettisoned, illegality in the contract, certain statutory exceptions under the Merchant Shipping Act, and any special exceptions incorporated with the contract.

The common law duty of the carrier is to take all reasonable care and to ensure the safety of the goods, where he has been paid for their carriage. If, however, there is no payment, he is liable only for loss or damage due to his want of careful management.

A common carrier (as has been seen elsewhere, Part V, Chapter V) is one who is engaged in a general business for the carriage of goods, and who holds himself out as ready to carry the goods of anyone. Apart from being a common carrier, as is ordinarily a person taking cargo in a general ship, a shipowner is liable for the safe carriage of goods received, unless the ordinary liability has been varied by the contract, as it frequently is. A common carrier is bound to take goods if he has room, and to carry them at a reasonable rate.

In 1671, the case of *Morse v. Slue* decided that where the cargo on a vessel lying in the Thames which had been shipped for Cadiz was taken by robbers before sailing, the master was liable, although he had not been guilty of any negligence.

"Act of God"

The "act of God", as Lord Justice James said in *Nugent v. Smith* (1876), "is a mere short way of expressing this proposition: a common carrier is not liable for any accident as to which he can show that it is due to natural causes, directly and

exclusively, without human intervention, and that it could not have been prevented by any amount of foresight and pains and care reasonably to be expected from him". This was the case of the carriage of a mare from London to Aberdeen, the ship encountering exceptionally rough weather, and the injuries incurred being due partly to the rough weather and partly to the restlessness of the animal itself. The defendant was held not liable, because a carrier does not ensure against the irresistible act of nature or against defects in the thing carried.

The King's Enemies

This exception covers acts done by states and peoples with whom the Sovereign of the shipowner is at war at any time during the carriage of the goods. The exception does not include robbers by land, although it includes pirates (generally an express exception), as the enemies of all civilized states. The master is justified in putting into port and delaying the voyage in order to avoid capture by the enemy. (See also as to Deviation, Chapter VII of this Part.)

Inherent Defects

It is a well-established exception to the ordinary liability of the carrier that he is not answerable for loss resulting from some defect in the thing carried which is not due to the method of carriage or stowage or any want of care on the part of the ship, considering the knowledge possessed or which ought to be possessed by the shipowner or the ship's servants as to the character of the goods carried. For example, loss resulting from the illness of animals, change in perishable goods, or change in goods due to heat or other natural cause or defective packing, provided that the shipowner has not received notice and ought not to have taken special precautions having regard to the character of the goods, must fall upon the shipper.

This exception will also cover damage due to defect in the particular goods carried, as where machinery was broken in consequence of a flaw in its make.

Shippers are bound not to ship dangerous goods or goods dangerously packed without disclosing their nature. (See also p. 50.)

Jettison

The shipowner is not liable for the loss of goods properly jettisoned (see also p. 50), or damage in consequence of efforts made to preserve the ship and cargo, as where water was poured on goods to put out fire. This exception was established so long ago as 1609, in *Mouse's Case.* The Gravesend ferry was overloaded, and in danger of sinking with several passengers. A casket and £113, besides other goods, were thrown overboard to lighten the ferry and to save life. It was held that the ferry owner was not liable, apart from the question as to whether he was responsible for overloading. In a case of imminent danger the master has a right to throw cargo overboard. He may select what articles shall be sacrificed, and, if necessary, even the whole cargo may be jettisoned. The ship and cargo contribute to the loss according to average. (See Chapter IX of this Part.)

Illegality

It is an excuse for the performance of the contract that it is illegal at the time according to British law or the regulations of the British Government, or if it subsequently becomes illegal owing to a declaration of war. But the exception does not include the acts of those who are unauthorized, nor the acts of foreign governments, except perhaps where the carriage is in a foreign ship and it is prevented by the act of the government of that ship.

Fire

It is provided by the Merchant Shipping Act, 1894, sec. 502, that the owner of a British seagoing ship is not to be liable to any extent whatever for loss or damage happening without his actual fault or privity where any goods, merchandise, or other things whatsoever taken in or put on board his ship are lost or damaged by reason of fire on board the ship. This exemption will apply even though the owner has been guilty of a breach of the warranty of seaworthiness, unless by the terms of the contract the operation of this section of the Act has been excluded.

Special Goods

The same exception applies in the case of owners of British ships duly registered where any gold, silver, diamonds, watches, jewels, or precious stones are taken in or put on board the ship, the true nature and value of which have not at the time of shipment been declared by the owner or shipper to the owner or master of the ship in the bills of lading or otherwise in writing, and they are lost or damaged by reason of any robbery, embezzlement, making away with, or secreting.

Limitation of Owners' Liability

The owners of a ship, British or foreign, are not liable for damages where the occurrence takes place without their actual fault or privity, beyond certain amounts:

(*a*) Where any loss of life or personal injury is caused to any person being carried in the ship;

(*b*) Where any loss or damage is caused to any goods, merchandise, or other things whatsoever on board the ship;

(*c*) Where any loss of life or personal injury is caused to any person carried in any other vessel by reason of the improper navigation of the ship;

(*d*) Where any loss or damage is caused to any other vessel or to any goods, merchandise, or other things whatsoever on board any other vessel by reason of the improper navigation of the ship.

The limitations on the amount of damages recoverable are as follows:

In respect of loss of life or personal injury, either alone or together with loss of or damage to the vessel, goods, merchandise, or other things, an aggregate amount not exceeding £15 for each ton of their ship's tonnage; and in respect of loss of or damage to vessels, goods, merchandise, or other things, whether there be in addition loss of life or personal injury or not, an aggregate amount not exceeding £8 for each ton of their ship's tonnage.

The tonnage for the purpose of a steamship is her registered tonnage, with the addition of any engine-room space which has been deducted for the purpose of ascertaining that tonnage. The tonnage of a sailing ship is her registered tonnage. Any space occupied by seamen or apprentices and appropriated to their use which is certified under the regulations is not included in such tonnage. The tonnage of a foreign ship is, if possible, ascertained by measurement according to British law, otherwise it is certified by the surveyor-general of ships in the United Kingdom, or the chief measuring officer of any British possession abroad.

The owner of every sea-going ship or share in it is liable in respect of every such loss of life or personal injury, loss of or damage to vessels, goods, merchandise, or other things arising on distinct occasions to the same extent as if no other loss, injury, or damage had arisen.

The limitation of liability is extended by the Act of 1900 to all cases where, without the owner's actual fault or privity, any loss or damage is caused to property or rights of any kind, whether on land or water, or whether fixed or moveable, by reason of the improper navigation or management of the ship.

A similar limitation is also put upon the liability of the owners of any dock or canal, or of a harbour or conservancy authority, in respect of loss or damage caused to any vessels or goods within their jurisdiction.

As to the application of this rule to any carriage where part of the transit of the goods is by sea, and as to the general exemptions enjoyed by railway companies, see Part V, Chapter V.

Pilotage

The owner or master of the ship is not answerable to any person whatever for any loss or damage occasioned by the fault or incapacity of any qualified pilot acting in charge of the ship within any district where the employment of a qualified pilot is compulsory by law. The loss must be due to some fault or incapacity of the pilot, for his presence on the ship does not relieve the master and crew from the proper discharge of their ordinary duties. As to the employment of pilots, see Chapter V of this Part.

Carriers' Negligence

The carrier is not entitled to the benefit of implied exceptions if he has been negligent or if he has deviated from the voyage, nor if the ship was unseaworthy on sailing and the loss would not have arisen but for that unseaworthiness.

Implied Terms

Terms are implied in every contract for sea carriage as to seaworthiness of the vessel, for reasonable dispatch of the goods, and that the ship shall not deviate except for the purpose of saving life or protecting the ship and cargo from imminent peril. (See also Chapter VII of this Part.) It is almost invariably the case that these implied terms are subject to express stipulations.

Seaworthiness

It is an absolute undertaking on the part of the shipowner that the ship, machinery, and equipment are seaworthy for ordinary purposes, that they are fit for the special voyage and for the carriage of the particular cargo. (As to express exceptions, see p. 51.) This carries with it the warranty that the ship is navigated by a competent master and crew, that a pilot will be taken on board at the usual places where a pilot is needed, and that the cargo will be safely and pro-

perly stowed. (See Chapter VII of this Part.) The undertaking is that the shipowner at the time of receiving the cargo and at the time of sailing will have taken all the precautions which a prudent shipowner would take in regard to a ship. The general equipment of the vessel will include requirements as to special fitness for a particular cargo; as, for example, that the refrigerating machinery is in proper order for the carriage of a cargo of frozen meat.

Where a voyage is to be undertaken in stages, it is usually sufficient if the ship is equipped for the first stage; and so on for each subsequent stage.

Deck Cargo

Deck cargo is that which is carried either in an uncovered space on deck, or in any covered space not included in the contents according to the ship's registered tonnage.

In the case where it is carried, this alone may not make the ship unseaworthy, but liability depends rather upon the facility with which such deck cargo could be got rid of, as in certain cases there would be no danger.

If any ship arrives between 31 October and 16 April at any port in the United Kingdom, or any port out of the United Kingdom, carrying timber as deck cargo, the master and owner, if privy to the offence, is liable to a fine of £5 per thousand cubic feet of timber so carried. Goods placed on deck owing to bad weather are excepted. Rules are made by the Board of Trade as to the carriage of wood as deck cargo.

Carriage of Grain

Obligation is imposed upon the master and any agent of the owner of the ship charged with the loading or sending her to sea to take all necessary and reasonable precautions in order to prevent grain cargo from shifting. In default there is a fine of £300. For grain cargoes laden in a port of the Mediterranean or Black Sea, or on the coast of North America, special precautions must be taken as laid down in the Act, and the Board of Trade regulations must be complied with.

Deviation

It is usual for a term of the contract to provide that a vessel may deviate not only for saving life, but also for saving property. (See also Chapter VII of this Part.)

Dispatch

Dispatch is an implied undertaking on the part of both merchant and shipowner. If there is no stipulated time, it is implied that a reasonable time only shall be taken in loading and discharging. (See also Chapter VII of this Part.)

CARRIAGE IN A GENERAL SHIP

When the whole or the principal portion of a ship is engaged, the contract is by charter-party (see p. 44); but when goods are shipped in what is known as a general ship or a ship "on the berth", the contract is usually by bill of lading. Where the shipment takes place in a ship belonging to a regular line, the terms of the bill of lading are generally well known, and such a bill of lading will therefore usually form the actual contract; but in other cases, although the bill of lading is evidence of the contract, it may or may not contain its whole terms, as the contract may have been made before the bill of lading was issued, or be affected by the terms of the mate's receipt, by shipping cards, advertisements, and other announcements as to the ship made by the owners or shipbrokers.

The carriage may be accepted on a through bill of lading covering shipment by several ships or by ship and rail or other land carrier.

Shipment of Goods

The usual course is for the terms of shipment to be arranged and for the goods to be delivered to the ship. A mate's receipt is then given for them. Except in short coasting voyages, the mate's receipt is afterwards exchanged for bills of lading. On every contract for carriage by sea, certain terms, as we have seen, are implied, although it usually happens that express terms govern the contract. For the breach of an engagement to ship goods there may be an action for damages.

Special contracts obtain in particular trades which require peculiar conditions of shipment and carriage and therefore a varied wording of the bill of lading. The usual course is for the bill of lading to be procured from the ship's agent and filled up by the shipper with the particulars of his shipment, the number of packages, and marks. It is then checked on behalf of the ship and signed by the master or ship's agent,

generally being exchanged for the mate's receipt, as the holder of the mate's receipt is usually the person entitled to the bill of lading. The mate's receipt may, however, have changed hands, but as it is not a negotiable instrument, title to the goods does not pass by its delivery, and notice must be given to the ship of the transfer of the goods. The bill of lading requires a 6*d.* stamp. It is usual for convenience of transmission for bills to be issued in sets of three or four, "one of which being accomplished, the others to stand void". The master keeps one of the bills; the rest are given to the shipper.

Shipowner's Liability

It is not competent for the shipowner to alter the terms of the contract of carriage after goods have been put on board.

Every bill of lading in the hands of a consignee or endorsee for valuable consideration, representing goods to have been shipped on board a vessel, is conclusive evidence of such shipment as against the master or other person signing, notwithstanding that the goods may not have been so shipped, unless the holder of the bill had actual notice at the time of receiving it that the goods had not been put on board. The master or other person signing may exonerate himself by showing that such misrepresentations were caused without any default on his part and wholly by the fraud of the shipper or the holder or some person under whom the holder claims.

A shipowner is liable for the delivery of goods, but he is not in the ordinary course responsible for any defect or want of quality in the goods. The usual terms are so many parcels "marked and numbered as in the margin, weight and contents unknown". He is not responsible, therefore, for delivery of goods with special marks, even when they indicate quality, as where goods of the same description belonging to different owners are shipped together and become mixed.

The bill of lading as a rule contains the terms "received in good order and condition", and if there is any qualification of these terms, it will not be a "clean" bill of lading. Where in one case goods were damaged before shipment, but nevertheless the master signed a bill of lading "shipped in good order and condition", although the damage was apparent, the shipowners were held bound by the representation of the master on the bill of lading that the goods were in good order and condition, because third parties, who could not have known, were affected. Purchasers of the goods from the shippers before delivery as endorsees of the bill of lading had altered their position and acted to their own prejudice on the face of that representation, and therefore the shipowners were not entitled to deny the truth of the representation. They were held liable for not delivering the goods in good order and condition, the damages being the difference in price paid and the value, with reasonable expenses—*Compania Naviera Vasconzada v. Churchill and Sim* (1906).

The shipowner's undertaking is for safe delivery, subject to excepted perils, and even implied exceptions must be inserted in the express contract. It always happens that the express exceptions go far beyond those implied, which have been already noticed.

All exceptions are construed as against the shipowner, whose common-law liability must be distinctly rebutted. Exceptions apply during the loading, the voyage, and the discharge of the cargo. There may be a general limitation of liability by a special clause in the bill of lading, even where the loss is not through excepted perils; for example, where it is agreed that shipowners are not to be liable above a certain amount for goods unless their value is declared. Such a limitation would not, however, affect the ordinary warranty of seaworthiness or relieve the shipowner from general average contribution. Exceptions differ in every trade in number and scope, and there is a tendency to enlarge them.

The following is a form of Bill of Lading, with some of the usual special clauses and exceptions:

Form of Bill of Lading

The ..... Steamship Company, Limited, and The ..... Company, Limited.

SHIPPED or delivered for shipment in apparent good order and condition by ..... on board the steamship ..... lying in or off the port of ..... with liberty to call at any ports and in any order, to sail without pilots, and to tow and assist vessels in distress, two hundred and fifty PACKAGES, being marked and numbered as in the margin; for delivery from the ship's deck (where the carrier's responsibility ceases), subject to ship's engagements not hereby disclosed, and though altering the voyage or involving a deviation therefrom, at the port of ..... or so near thereunto as she may safely get (the Act of God; the King's enemies; robbers or thieves by land or sea; restraint of princes, rulers, or people; perils of the sea, barratry of the master or crew, jettison, effect of climate, heat, fire or water, leakage, stranding, collision, and the consequences of such dangers and accidents excepted), unto ..... or to the order of .... or to his or their assigns.

XO

1/250

Freight and primage for the said goods as per margin is to be paid by the shippers in ..... Average, if any, to be adjusted according to York-Antwerp Rules, supplemented by English practice where such rules contain no provision (See Chapter IX of this Part.)

General average loss to be borne by those on whom it has fallen.

Freight @

Weight, measurement, contents, and value (except for the purpose of estimating freight) unknown. [The owners will not be responsible for valuable packages, unless freight has been paid *ad valorem*, and contents and value inserted in the shipping note, and Bill of Lading signed in accordance therewith. A valuable package is one of greater value than ..... pounds, or one whose contents or any part thereof exceed in value ..... pounds per cubic foot for measurement, or per one cwt. for weight cargo. Liability for the loss of or damage to any piece or package shall never exceed the invoice value of such piece or package.]

Demurrage ..... pounds per day for detention of ship, if caused by consignees not taking delivery as fast as steamer can discharge. (See Chapter VII of this Part.)

The shipowners to have a lien on the cargo, though landed, for any expense or liability incurred in consequence of giving bond at a previous port for the customs duty on the cargo.

Any claim that may arise hereunder must be made at the port of delivery.

Shippers, whether principals or agents, shall be liable for loss or damage to any person or interest whatsoever caused by dangerous or injurious goods shipped without full disclosure of their nature and whether shippers are aware thereof or not. Such goods may be destroyed without compensation.

[If the discharge of the cargo be, or threaten to be, impeded by bad weather, or by absence from whatever cause of facilities of discharge or landing, the master to have liberty at ship's expense but shipper's risk from the time of leaving ship's deck to land and store the whole or part of the cargo or put same into hulk, lighter, or craft, or proceed on the voyage with the whole or part of the cargo, and either discharge it on the return voyage or forward it to destination from another port, always subject to the conditions of the forwarding conveyance.]

This Bill of Lading shall constitute the contract between the owners of the goods and the shipowners, which shall be construed and governed by English law and shall apply throughout the transit.

In WITNESS whereof the master or agent of the said ship has signed ..... bills of lading, all of this tenor and date, one of which being accomplished the others to stand void.

Dated at .....

By Authority of Owners,

.....

Master or Agent.

Common Exceptions

The common exceptions are as follows: the "*Act of God*" and the *King's Enemies* (see p. 45); *Restraint of princes*, which means the interference of any constituted government or ruling power of any country, whether enemy or not, as the effect of quarantine or embargo. If a ship carries enemies' goods, this is a breach of duty towards the other shippers, and the exemption "restraint of princes" cannot be pleaded by the shipowner —*Dunn v. Bucknall* (1902).

"*Pirates*" are generally specially excepted, although probably included under the "King's Enemies".

"*Robbers or thieves*" ordinarily mean those without the ship, and the exception would therefore not cover acts of the crew or passengers; but it is usual for a clause to be used "robbers or thieves by land or sea, whether on board or not, or in the service of the owners of the carrying ship".

"*Perils of the seas, ports, rivers, and of navigation, and the consequences of all such dangers and accidents.*"—This is an extended term implying much more than the term "perils of the sea" simply. The expression "perils of the sea" does not mean the consequence of other perils arising on the sea, such as damage due to the inevitable action of wind and waves resulting in wear and tear, but a peril, such as foundering, caused by collision. "Perils of the sea" covers damage to the goods carried by sea owing to storms, strandings, &c., which could not have been foreseen and guarded against by the shipowners taking reasonable precautions—*The Xantho* (1887). The term also includes damage of which some peril of the sea was the approximate cause; as, for example, where the cargo was damaged by heat from the engine and boilers, caused by weather which compelled the closing of the ventilators for a long time—*The Thrünscroe* (1897).

In the same way, where a cargo of rice had been damaged by sea water in consequence of rats having gnawed a hole in a lead pipe from the ship's bathroom to the sea, there being no negligence of the shipowner, loss resulting was decided by the House of Lords to be within the exception, and shipowners were not liable—*Hamilton v. Pandorf* (1887). Generally, when sea damage starts the mischief, the effects of its spreading come within the exception; as, for example, where tobacco was injured by contiguity to hides which formed part of the cargo and had been soaked by sea water. But if the damage arises from sea water owing to some defect in the ship due to natural causes, such a damage will not be within the exception "perils of the sea"; as where the natural decay of a hulk in which goods were stored cause a leak which let in the water and injured the goods—*Sassoon v. Western Assurance Company* (1912).

"Perils of the sea" does not, however, cover loss by arrest for contraband or under bottomry bond, but refers to some accidental loss; nor does it cover the negligence of the captain or crew, which, however, is often the subject of another exception.

"*Collision*" does not cover a case due to the default of the master or crew of the carrying ship. (See Chapter V of this Part.)

Strandings and Collisions may be "perils of the sea", but are usually expressly provided for and then made to cover negligence, defect, or error of judgment of the pilot, master, mariners, or other servants of the shipowners.

"*Barratry of the master or crew*" means a wilful or wrongful act against the ship or the goods, as an attempt to scuttle the ship, or illegal trading with the enemy even if it is intended to benefit the owner. Barratry includes crime or fraud which could not reasonably have been prevented by the owner or master, but not their negligence.

Jettison is the throwing overboard of goods to lighten the ship in time of peril. The exception will not cover goods jettisoned because improperly stowed.

"*Fire*" is a statutory exception already noticed (p. 45), but the express terms of the exception may be wider and cover goods not yet received on board. "Heat" in connection with fire means heat caused from outside sources.

"*Leakage*" and "*Breakage*" cover loss due to the leaking or breaking of the goods themselves; but if loss is due to defective stowage, the shipowner will be liable.

"*Sweating*", &c., includes damage caused by evaporated moisture.

"*The dangerous character of the goods.*"—It is an implied term that the shipper will not put on board goods of a dangerous character or goods dangerously packed without declaring their nature. The shipowner is exempt from liability in respect of such goods if the character was not known or could not reasonably have been known.

A person sending or attempting to send in any vessel any dangerous goods without distinctly marking their nature on the outside of the package and giving written notice of their nature and of the name and address of the sender or consignee to the master or owner of the vessel, commits an offence, and is liable to be fined £100, or an innocent agent £10. It is an offence to misdescribe such goods, subject to a penalty of £500. The master or owner of any vessel may deal summarily with goods suspected of being dangerous, and

such goods are forfeited if improperly sent or carried.

"*Negligence of the master.*"—It is now common to include a term exempting the shipowner from liability on account of negligence of the master and crew, and often also negligence or default of owner's agents, stevedores, pilots, and others employed in connection with the ship, or whether employed by the owner of the ship or not, for whose acts the owner would otherwise be liable. Such an exception is construed strictly. Negligence in navigation will not cover negligence in stowage, but where the negligence was made to cover negligence "in navigating the ship or otherwise", it was held that the shipowners were exempt from claims for damage due to negligent stowage—*Baerselman v. Bailey* (1895).

The personal negligence of the shipowner is not generally covered by express exception, and he will be responsible for improper employment, as for the engagement of a master or mariner without sufficient skill. If there is such an exception in regard to the shipowner, it will not cover unseaworthiness. But there may be an exception against unseaworthiness itself. This must be very clearly expressed. The shipowner who has not taken reasonable means in accordance with the contract to provide against unfitness to receive cargo is liable for loss, and cannot rely in such a case upon an exception as to unseaworthiness —*Rathbone v. MacIver* (1903).

"*Loss covered by insurance.*"—It is sometimes stipulated that owners shall not be liable for any damage to the goods which is capable of being covered by insurance, or which has been wholly or in part paid for by insurance. The question then is whether an underwriter in the ordinary way of business would have covered such a peril.

"*Merchants' and owners' risk.*"—Such a clause may throw all risks upon the shippers, including the effect of "negligent and improper acts"; but a condition with such a wide scope must be clearly understood, and will be read in reference to the subject-matter. It will not exempt a carrier from his elementary undertaking to deliver the goods.

The "Harter Act"

By the Harter Act of Congress of 1893, under United States law clauses exempting the shipowner from liability for his own or servants' negligence are void as against public policy. Limitations of liability must be reasonable, or no effect will be given to them by United States law. The Act, on the other hand, exempts the shipowner from the consequences of faults and errors in navigation, or in the management, or other perils, where he has exercised due diligence to make the vessel in all respects seaworthy, properly manned, equipped, and supplied.

It is not lawful under this Act for the manager, agent, master, or owner of any vessel transporting merchandise or property from or between ports of the United States of America or foreign ports, to insert in any bill of lading or shipping document any agreement relieving them from liability for loss or damage arising from negligence, fault, or failure in proper loading, stowage, custody, care, or proper delivery of any and all lawful merchandise shipped in such vessel. Any such clause is null and void.

It is not lawful to insert any agreement whereby the obligations of the owners to exercise due diligence properly to equip, man, provision and outfit and make seaworthy the vessel, or carefully handle or stow and deliver cargo, are in any way lessened, weakened, or avoided.

If such an owner exercises due diligence in making seaworthy and in properly manning, equipping, and supplying the vessel, neither the vessel, the owner, agent, or charterer is responsible for damage or loss resulting from faults or errors in navigation or management, nor for losses arising from any dangers of the sea or other navigable waters, act of God, enemy, inherent defect, &c., insufficiency of packing, or seizure under legal process, or any loss resulting from any act or omission of the shipowner, his agent or representative, or from saving or attempting to save life or property at sea, or for any deviation in rendering such service.

It is the duty of the owner, master, or agent of any such vessel to issue to the shipper a bill of lading or shipping document stating the marks necessary for identification, number of packages or quantity, &c., and apparent order and condition of the goods, and such document is *prima facie* evidence of the receipt of the goods. An agent, owner, or master is liable for violation of the provisions of the Act to a fine, which is a charge upon the vessel.

The incorporation of the Harter Act (which is common in Atlantic shipping contracts) with the bill of lading was held to excuse fault or error in management or mismanagement of a refrigerating apparatus, part of the ship, whereby a cargo of butter was damaged—*Rowson v. Atlantic Transport Company* (1903). But where there is a defect in the equipment of a vessel at the time of loading, the incorporation of the Act will not excuse the owners from liability for damage caused to cargo through such a defect, which is a breach of the implied warranty that the ship is fit for the reception of cargo—*M'Fadden v. Blue Star Line* (1905).

Construction of Clauses with Exceptions

Clauses creating exceptions to the ordinary liability of the shipowner must be read together. In a certain case one clause provided for the exemption of the shipowner from loss due to "any other cause whatsoever", but another clause provided against defects, &c., if reasonable means were taken to provide against such defects and unseaworthiness, and the ship had not been cleansed from carbolic acid before a cargo of frozen meat was shipped. It was held that the general exception could only be relied upon if all reasonable means had been taken to provide against the mischief—*Elderslie Steamship Company v. Borthwick* (1905).

Such a general exception as a rule covers unseaworthiness; but where a frozen meat cargo was carried on a contract so ill expressed that it was impossible to feel sure what the parties intended, it was held that as there was no clear and express exemption, the shipowners were not relieved from the usual duty to provide a seaworthy ship and take seasonable care—*Nelson Line v. Nelson* (1908). This case only illustrates the rule that the onus is upon the shipowner to negative his ordinary liability.

The Bill of Lading

The Bill of Lading is the receipt for the goods shipped on board, and is signed by the person contracting to carry them, the master, or ship's agent. It states the terms on which the goods are to be carried, and is evidence of the contract between the parties, if not actually by its terms made to be the contract. The contract, like any other contract, is void for illegality. There is always a presumption that the law governing the bill of lading is the law of the ship's flag, which is generally stipulated for; otherwise local laws, usages, and customs may be binding. The master or broker cannot bind the owner by signing bills of lading when goods are not actually shipped, nor by a fresh bill of lading when he has already signed one.

A bill of lading is a document of title and, where no charter-party exists, the most important evidence of the contract. It is a negotiable instrument, the property in which may be transferred by endorsement and delivery after the shipment of the goods. By the Bills of Lading Act, 1855, every consignee of goods named in and every endorsee of a bill of lading to whom, under the particular circumstances of the endorsement, the property in the goods shipped under the bill of lading passes, has all the rights of suit and is subject to the same liabilities in respect of such goods as if the contract contained in the bill of lading had been made with himself. This does not affect the right of stoppage *in transitu* by a vendor of goods, or the right to claim freight against an original shipper, or any liability of consignee or endorsee in consequence of such consignment or endorsement. Under the Admiralty Jurisdiction Act, 1861, an endorsement may give rights of action to the endorsee in the Court of Admiralty against the carrying ship when no owner or part owner is domiciled in England or Wales. (See Chapter IX.)

Property may be completely transferred by endorsement and delivery of the bill of lading in exchange for the price, or when goods are shipped by a vendor in fulfilment of an order, on its delivery to the buyer the bill of lading *prima facie* passes the title to the goods; but an unpaid vendor has, under certain conditions, the right to stop goods *in transitu*. An unpaid vendor may also reserve certain rights and thus prevent the passing of the property. He may arrange for delivery of the goods to his own order or to an agent, and for the bill of lading only to be given up on demand. In this way the vendor reserves the right of disposal. This is commonly done either by sending the bill of lading accompanied by a bill of exchange; and under the Sale of Goods Act the buyer is bound to return the bill of lading unless he accepts the bill of exchange; or both bill of lading and bill of exchange may be remitted through a bank, when the buyer only becomes entitled to the bill of lading after accepting and on retiring the bill of exchange. This is a common method employed when the sale is for cash against documents. The right to stop *in transitu* has been considered elsewhere in connection with the sale of goods. (See Part III, Chapter VI.)

The right to stop goods may arise on the bankruptcy or insolvency of the buyer as well as on his refusal to pay, and even if there has been a part payment. The right of stoppage may be exercised by an agent on behalf of the vendor, by a surety for the buyer who has paid the vendor, or by a person whose authority is subsequently ratified by the vendor. The right exists as against the buyer and all claiming through him, except a *bona-fide* holder of the bill of lading which has been endorsed and delivered to him for value. Owing to the negotiable character of the bill of lading, such a *bona-fide* holder is in a position to defeat the unpaid vendor's title.

The charges of the carrier for freight are superior to the unpaid vendor's lien.

If a bill of lading has been endorsed to a third party by way of mortgage or pledge, the vendor

has only the right to stop the property subject to paying off the charge.

"Transit", during which the right to stop subsists, is not ended by wrongful or mistaken delivery on the part of the carrier, nor is it prolonged by the carrier's wrongful refusal to deliver; but transit comes to an end directly there is a delivery of the goods to the vendor or his agent, or delivery to a forwarding agent on the instructions of the buyer, or where by any agreement the carrier holds for the buyer. All these questions are questions of fact, and each case depends upon its own circumstances. Notice must be given to a person holding the goods if the stoppage is to be effective, and it then becomes the duty of that person to deliver to the vendor or his order, although in case of doubt an indemnity may be asked for.

CARRIAGE BY CHARTER-PARTY

When the whole or the principal portion of the ship is engaged, the contract is made by charter-party. There may be a question as to whether in such a case there is a demise of the ship, that is to say, whether the owner has surrendered the ship to the charterer, who thereupon obtains control, the master and seamen becoming his servants. This is, however, very unusual, and in case of doubt the test to be applied is, whose servants are they who are in charge of the ship? What generally happens is that the shipowner retains control and navigates with his own master and crew, and the charterer undertakes to load the prescribed cargo at the port of loading and accept delivery at the port of discharge. This is obvious, for the merchant does not wish to become shipowner but merely to secure the carriage of his goods.

The ordinary forms of charter are either for the use of a ship on a particular voyage to carry particular goods to be shipped by the charterer, or a similar charter with liberty given to the charterer to carry goods of any shippers as in a general ship, or a charter of a ship for a particular time. Where it is indicated that the ship shall be used as a general ship, and generally to enable a charterer to negotiate the sale of part of a cargo, it is provided by a clause in the charter that the master shall sign bills of lading as presented by the charterer without prejudice to the charter-party (see p. 56).

The charter-party is invariably in writing and requires a 6*d.* stamp, an adhesive stamp being cancelled by the person who first signs.

Every charter contains several well-known general terms, but particular terms are incorporated in charters relating to special voyages or cargoes. The implied terms in every contract of sea carriage have been already noticed (see p. 44). These terms are usually in a charter-party extended by agreement and supplemented by others with further limitation of the liability of the shipowner. There may be a clause consigning the ship at the port of discharge to the agents of the charterers for the procuring of a home freight at an agreed rate of commission. It will be more serviceable now to consider the form of the charter-party and examine some of the usual conditions, taking for an example a charter for coals.

Form of Charter-party

London....., 19...

IT IS THIS DAY MUTUALLY AGREED between ....., Owner of the good (Steam)ship called the ....., classed ..... of ..... tons net register, ... tons deadweight, exclusive of bunkers, or thereabouts, ... now at ....., and expected ready to load about ..... AND ....., Charterers, ...

1. THAT the said Ship being warranted tight, staunch, and strong, and every way fitted for the Voyage, shall, with all possible dispatch, sail and proceed to ..... and there load, (always afloat) in the customary manner, from the Charterers, [in such Dock as may be ordered by them on or before arrival in, or at .....], a full and complete Cargo of ..... *Coals* not exceeding ..... tons, nor less than ..... tons, and not exceeding what she can reasonably stow and carry, over and above her Tackle, Apparel, Provisions, Fire, Coal, and Furniture; and being so loaded, shall therewith proceed, with all possible dispatch, to ....., or so near thereunto as she can safely get, and there deliver her cargo alongside any Wharf, and/or Vessel, and/or Craft, as ordered by Charterers' agents [to whom written notice is to be given of the vessel being ready to discharge,] on being paid Freight at the rate of ..... per ton of 20 cwt. [or on Bill of Lading quantity less 2 per cent, at Receiver's option, to be declared in writing before bulk is broken]. The freight is in full of Trimming, and of all Port Charges, Pilotages, and Consulages on the Vessel. [All Wharfage dues on the Cargo to be paid by the Charterers.]

2. The cargo to be loaded in ..... running hours (excluding Bunkering time, Sundays, Custom House, Colliery, and other Holidays, and from

..... p.m. on Saturday or the day previous to any such holiday to ..... a.m. on Monday or the day after any such holiday unless used), commencing when written notice is given of Ship being completely ready to load. [Any time lost through riots, strikes, lockouts, or any dispute between masters and men occasioning a stoppage of pitmen, trimmers, or other hands connected with the working or delivery of the coal for which the Ship is stemmed, or by reason of accidents to mines or machinery, obstructions on the Railway or in the Docks; or by reason of floods, frosts, fogs, storms, or any cause beyond the control of the Charterers, not to be computed as part of the loading time (unless any cargo be actually loaded during such time). In the event of any stoppage or stoppages arising from any of these causes continuing for the period of ..... running days from the time of the vessel being ready to load, this Charter shall become null and void, provided, however, that no Cargo shall have been shipped on board the Ship previous to such stoppage or stoppages. In case of partial holiday or partial stoppage of Colliery or Collieries from any or either of the aforenamed causes, the lay hours shall be extended proportionately to the diminution of output arising from such partial holiday or stoppage.] If longer detained, Charterers to pay per running hour demurrage at..... No deduction of time shall be allowed for stoppages, unless due notice be given at the time to the Master or Owner.

[Any question arising under this clause shall be referred to ..... and ..... as arbitrators, or should they be unable to agree, to an umpire selected by them, whose decision shall be final.]

3. The Cargo shall be trimmed by men appointed by the Charterers at the tariff rate of the Port.

4. Bunker Coals are to be kept properly separated from Cargo to Charterers' satisfaction at the Ship's expense and the quantity to be endorsed on the Bills of Lading.

5. The Bills of Lading shall be prepared in accordance with the Dock or Railway weight, and shall be signed by the Master, Agent, or Owner, weight unknown, freight and all conditions as per this Charter, such Bills of Lading to be signed within ..... hours after the Ship is loaded.

6. The Act of God, the King's Enemies, Restraints of Princes and Rulers, and Perils of the Seas excepted; also Fire, Barratry of the Master and Crew, Pirates, Collisions, Strandings and Accidents of Navigation, or latent defects in, or accidents to, Hull and/or Machinery, and/or Boilers, always excepted, [even when occasioned by the negligence, default, or error in judgment of the Pilot, Master, Mariners, or other persons employed by the Shipowner, or for whose acts he is responsible, not resulting, however, in any case from want of due diligence by the Owner of the Ship, or by the Ship's Husband or Manager]. Charterers are not to be answerable for any negligence, default, or error in judgment of Trimmers or Stevedores employed in loading or discharging the Cargo.

7. The Ship has liberty to call at any ports in any order, to sail without Pilots, to tow and assist vessels in distress, and to deviate for the purpose of saving life or property.

8. The Cargo is to be taken from alongside by Consignees at port of discharge, free of expense and risk to the Ship, at the average rate of ..... tons per day, weather permitting, Sundays and holidays excepted, provided Ship can deliver it at this rate (or as fast as Ship can deliver); if longer detained Consignees to pay Ship demurrage at the rate of ..... per net register ton per running day, time to commence when Ship is ready to unload and written notice is given, whether in berth or not. [In case of strikes, lockouts, civil commotions, or any other causes or accidents beyond the control of the Consignees which prevent or delay the discharging, such time is not to count, unless the Ship is already on demurrage.]

9. The FREIGHT to be paid (one-half) if required by the Owner, on signing Bills of Lading (Ship lost or not lost), in Cash, less ..... per cent for Insurance and Interest (the Owner or his Agent giving Charterers or Shippers written notice before the Ship commences loading, if any advance freight is required), and the remainder on right delivery of the Cargo, in ....., the Receivers of the Cargo to be bound to pay freight on account during delivery, if required by the Captain. (See Chapter VII of this Part.)

10. The Ship is to be free of address at Port of Discharge, but is to pay the usual Commission of ..... per cent on the amount of the Freight on signing Bills of Lading.

11. In case of Average, the same is to be settled according to the York/Antwerp Rules, 1890, and as if the Vessel were British. (See Chapter IX.)

12. Loading hours not to commence before ..... on ....., and if Ship is not ready in loading dock as ordered before ..... on ....., or if any wilful misrepresentation is made respecting the size, position, or state of the Ship, Charterers are to have the option of cancelling this Charter, such option to be declared on notice of readiness being given.

13. The Charterers' liability shall cease as soon as the Cargo is shipped, and the advance of Freight, Dead Freight, and Demurrage in Loading (if any) are paid, the Owner having a Lien on

the Cargo for Freight, Demurrage, and Average. (See Chapter VII.)

14. Penalty for non-performance of this Agreement, damages as proved, not exceeding the estimated amount of Freight.

15. The Brokerage of ..... per cent is due to ..... on the Cargo being loaded.

Witness to the signatures of

.....

Indorsement

We hereby Certify that the ..... has on board a Cargo of ..... Coals, wrought and gotten from ..... Colliery, fresh worked, properly screened, and of the best descriptions for steam purposes.

Conditions

Name, Description, and Capacity of the Ship.—The name and correct description of the ship must appear in the charter-party, the nationality and class being essential representations.

Tonnage.—The net register tonnage is usually given, and refers to the register tons of 100 cu. ft. The deadweight tonnage, however, is almost always named, which is the capacity of tons of 20 cwt., or by measurement 40 cu. ft., and represents the amount of cargo or thereabouts agreed to be shipped. Deadweight tonnage is a material representation, and the charterer will be bound to ship and the owners bound to receive cargo to that extent, but it is usual for a subsequent clause to stipulate as to that. This obligation may be different, however, in the case of a consignment of an unusual character.

In a certain charter-party providing for a lump-sum freight the owners guaranteed to carry 2000 tons deadweight, or otherwise to make a reduction *pro rata*, the cargo to be a general cargo subject to certain large pieces that were referred to in the margin. The charterers sent in cargo not in excess of 2000 tons, but it consisted of heavy machinery, as well as general goods. The larger pieces were more numerous than had been contemplated, and as a result the ship could only carry 1691 tons deadweight. The charterers were held not to be entitled to any deduction from the full lump-sum freight—*Mackill v. Wright* (1888).

"*Now in the port of.*"—The statement as to the whereabouts of the ship at the time of the charter-party is a condition precedent, and no contract begins until it is fulfilled. Where a charter said "now in the port of Amsterdam", this was held to be a warranty that the ship was there at the time of the making of the memorandum—*Behn v. Burness* (1863).

In a time charter readiness to proceed on the voyage is a condition precedent. It is usual to put in the charter the day on which the ship is expected to be ready to load.

"*Tight, Staunch, and Strong, and every way Fitted for the Voyage.*"—This is equivalent to the implied warranty of seaworthiness, and such fitness for the voyage and for the cargo is a condition precedent to the contract.

"*All Possible Dispatch.*"—It is an absolute undertaking to proceed to the port of loading and there to load with all possible dispatch and proceed on the voyage, subject to the excepted perils which have already been examined in discussing bills of lading (see p. 50).

Other exceptions may be provided for in a charter-party having in contemplation possible difficulties in securing the cargo. (Clause 2.) If the port is named in the charter-party, the ship must proceed there in due course. If it is to a port "as ordered", the ship must proceed when instructions are given to the port required. (See Chapter VII of this Part.)

"*Full and Complete Cargo.*"—It is the duty of the shipowner to be ready to load at the agreed place and to give notice to the charterers of such readiness.

"Readiness to load" implies that the charterer has complete control of every part of the ship in which cargo can be stowed, and that all needed papers and permits have been secured for the ship. It is the duty of the charterer to furnish cargo with the usual dispatch, unless he is expressly excused. His obligation is not (in the absence of express exception) removed by strikes, &c., which may prevent the cargo from being procured, or by weather, delays on railways, &c., which prevent its being loaded; but knowledge on the part of both parties at the time of the contract of such circumstances or local usages of the port may excuse him. After the loading is complete, all subsequent delay falls upon the shipowner.

Cargo must be delivered alongside so as to be taken direct into the ship, unless any special means of loading is customary in the port.

Demurrage.—If the ship is detained loading or discharging cargo beyond the time allowed, the charterers are called upon to pay demurrage at an agreed rate per hour or day, and it is usually stipulated that any dispute as to the time shall be referred to arbitration. (See Chapter VII.)

Cesser Clause.—It is sometimes provided (see Clause 13) that the charterer's liability shall cease on shipment of the cargo, and by the same clause

a lien is given to the shipowner for demurrage and dead freight, that is, for damages for breach of contract to load.

Exceptions in a charter-party must now be taken as a general rule to relate to both charterer and shipowner.

Freight

See Chapter VII of this Part.

Average

It is usually stipulated that the average shall be adjusted according to York/Antwerp Rules. (See Chapters VII and IX of this Part.)

Issue of Bills of Lading

It is usual to stipulate that bills of lading shall be issued for the cargo, the bills of lading to be prepared in accordance with the charter and signed by the master, agent, or owner within a certain time after the ship is loaded. These not only serve the charterer as evidence of the shipment, but are negotiable by him as ordinary bills of lading. Nevertheless, it is the charter which fixes the terms of the contract as between the shipowner and charterer. A bill of lading subsequently given cannot vary it. When, however, the bills of lading get into the hands of a *bona-fide* transferee for value the case may be different (see p. 52).

As far as the master is concerned, in signing bills of lading he signs in general as agent for the shipowner, although it may be agreed that the master is to sign bills of lading as required by the charterer. He must not sign them when inconsistent with the charter-party. Where there was a clause in a charter that the shipowner should not be liable for the master's negligence, and by mistake the master signed bills of lading presented by the charterers which did not give the shipowner this exemption, it was held that as the contract between the shipowner and the charterers was to the effect that the shipowner should not be liable for the master's negligence, the charterers were bound to indemnify the shipowner against claims of holders of the bills of lading—*Kruger v. Moel Tryvan Steamship Company* (1907).

CONSTRUCTION OF THE CONTRACT

Where there is a document containing the terms of the contract and its terms are clear, it governs the contract, as construed by the judge; but to explain a contract which is ambiguous or indefinite, evidence may be given. The ordinary meaning of the words is adopted; technical words and special trade meanings may be explained. The whole document must be read together, with the exception that where there are printed forms, and some of the printed terms differ from terms which have been written in, the printing is subordinate to the writing. A general and reasonable custom which is not contrary to law may add terms to the written contract.

NON-PERFORMANCE

A breach of contract by either party gives a right to damages. The general principle and the measure of damages have been discussed in dealing with the law of carriage elsewhere (see Part V, Chapter V). If a charterer refuses to load at all, or to load the agreed cargo, a right of action at once accrues to the shipowner; and failure to supply the ship or carry the goods safely gives a similar right to the charterer or goods owner. Damages may be agreed, and it is usual for a charter-party to contain a clause that damages shall be the estimated amount of freight. Such a provision, however, being in the nature of a penalty, is of little use, and it will be necessary to prove damages. Damages are such as may be said to have been within the reasonable contemplation of the parties at the time of contracting—the loss of freight and the market price of the goods are determining factors; but on a breach of the particular contract it is the duty of an owner to seek another cargo or a charterer another ship without undue delay.

Performance of the contract is always excused by its becoming illegal.

CHAPTER VII

THE VOYAGE AND DELIVERY OF THE CARGO

Introductory—The Ship—The Loading—The Voyage—The Delivery—Freight—Demurrage, &c.

INTRODUCTORY

It has already been seen that it is the duty of the shipowner with all diligence to provide a ship which is in every way seaworthy and fitted for the voyage. Where a ship is chartered, the charter-party will fix the time for loading, and there must be diligence in proceeding to the port of loading. Delay may dissolve the contract, as the prosperity of the whole venture may be affected by it. On the other hand, a refusal to load at the agreed place may discharge the shipowner from his liability. The agreement may be cancelled or may become void through the venture becoming contrary to law.

The ship must be provided with the necessary papers, all in order, with sufficient crew, and, where necessary, a pilot must be taken on board. The ship must be in readiness to receive the cargo at the appointed time and place, it generally being the duty of the shipowner to receive it alongside, according to the custom of the place. It may be in some cases the duty of the shipowner to fetch the cargo from the shore. How much, however, the cargo owner or shipowner respectively is compelled to do through his own wharfingers and lightermen in the absence of any terms in the contract depends very largely upon particular custom. The shipowner's liability for the goods begins with their receipt at the appointed place. The "excepted perils" (see Chapter VI of this Part) cover carriage to the ship if the shipper is liable for conveyance of the goods from the shore. It is the duty of the shipowner to provide the necessary tackle for lifting the goods on board, and to protect them when on board; and, in the absence of any agreement to the contrary, to stow the goods. (As to the carriage of deck cargo, cargoes of grain, and other special classes of goods, see Chapter VI of this Part.)

Whether stevedores are employed or not, the owners by their master are responsible for bad stowage.

The master must begin the voyage at a fit and proper time, with due regard to the weather, and in times of hostilities must sail under convoy. In the absence of any provision under the contract, the voyage must be by the shortest and safest route, although usage may justify a slight deviation. Deviation is otherwise a wrong, and for what happens when off the usual course the owner is liable, even for dangers of the sea and other excepted perils. Deviation is excused for the purpose of saving life, not property, for necessary repairs due to accident or tempest, and to escape from enemies. In all cases of necessary deviation it must be as slight as possible. (See page 59.)

On arrival at the port of discharge, the shipowner must deliver the goods to the person entitled, that is, generally to the party presenting the bill of lading. Freight is usually payable on the delivery of the goods, and demurrage or other charges may or may not give, as freight always gives, a lien on the goods. These and other questions arising out of the loading, the voyage, and the discharge are dealt with later on. In all such cases a special contract usually governs.

THE SHIP

As we have seen, the shipowner is bound to provide a seaworthy ship in readiness for the agreed purpose; otherwise freight will not be recoverable. The charterer may refuse to load an unseaworthy ship, or, if it is discovered to be unseaworthy after loading, he may recover the cost of landing and rehousing the cargo.

As far as possible the ship must be kept seaworthy during the voyage.

The owner must give notice of the arrival of the ship, in the case of a charter, at the agreed port of loading, and from the time of its arrival at that port the ship is at the disposal of the charterer.

THE LOADING

The loading of the ship must be in accordance with the terms of the charter-party, where such exists. The charter generally provides that the ship shall proceed to a certain port and there load, or shall proceed to a port as ordered. In that case the order must be given within a reasonable time, or the charter may be abandoned by the shipowner. Refusal of the charterer to load gives an immediate right of action to the shipowner. It is usual to provide for strikes, lockouts, floods, tempest, riots, political and civil commotions, and other exceptional causes preventing the shipment taking place in due course. These are generally known as "causes beyond the charterer's control", and are then made to excuse him for not providing the cargo or for delay in so doing (see form, Chapter VI). Without an express stipulation, the charterer would not be excused by the bankruptcy of the firm supplying cargo, delay on the railway, or other such cause of failure, unless it could be shown that at the time of contracting the parties were aware of these probable causes of delay. The charterer is supposed to have the cargo in readiness near the place of shipment, so that, even when excepted, such causes of delay occurring at a distance may not excuse the charterer for the non-provision of the cargo which ought to be on the spot.

The charterer must load a full and complete cargo, filling the whole of the carrying space of the ship, if he has chartered the whole ship, and where the deadweight capacity has been stipulated by the charter, he is entitled to load up to that capacity. An exception, however, may arise where goods of an unwieldy character are presented which have not been provided for in the charter-party. The ship must not be overloaded. In such a case the charterer may have to pay for the whole ship, though not being able to load up to the full tonnage. Where the charter is for part of the ship only, the rest of the ship remains at the owner's disposal for other or miscellaneous cargo.

Stipulations in the contract as to loading are construed according to the custom of the port; but a custom must be clearly proved.

The actual loading is done at the risk of the shipowner, unless it is provided otherwise by the contract. The employment of stevedores, even when approved by the charterer, does not relieve the shipowner from responsibility. His remedy is against the stevedores if the goods are damaged by them. Where jettison is an excepted peril, it will not avail the shipowner if the jettison was in fact due to the goods being improperly stowed. The shipowner will in such case be liable for their loss. The charterer must not send dangerous goods to be loaded unless with written notice of their character and unless the goods are properly marked. (See Chapter VI of this Part.)

It is the duty of the shipowner to protect ordinary cargo by the supply of the necessary dunnage, which prevents contact with the sides or bottom of the ship. It is also the duty of the shipowner to provide necessary ballast, although merchandise may be used for this purpose if offered. The shipowner will be liable for loss if different articles have been stowed together so as to be injurious to one another. In such a case it is not necessary to prove negligence, as the inference is that the shipowner, being liable for bad stowage, is answerable for the damage so arising.

Where it is stipulated that the loading or unloading shall take place at a certain port, this means a safe place for the loading or discharge of the ship, and it is usual to add the term "or so near thereto as she can safely get". (As to the time for loading and unloading, see "Demurrage", p. 63.)

THE VOYAGE

The master, having obtained the necessary clearance and permission of the Customs, and having paid any port dues or charges, must proceed on the voyage with all due speed by the usual course to the port of discharge. A vessel has "finally sailed" when she has left her port of loading or final port of call in the United Kingdom ready for the voyage, and with no intention of returning.

Deviation

The charter-party or bill of lading may reserve to the shipowner a certain liberty to deviate from the voyage, or a liberty to call at certain named ports, or a general liberty to call at ports, with liberty to aid and assist other vessels. But for some such provision, deviation, for any other purpose than the saving of life, necessary repairs, and avoidance of capture, would be a breach of contract. Deviation for the purpose of saving property alone is not justified.

In *Leduc v. Ward* (1888), a case in which it was attempted to justify a deviation on the ground that the shippers knew it was intended, Lord Esher, Master of the Rolls, held that that was no defence against the claim of the holder of the Bill of Lading. "A Bill of Lading is a common mercantile document, which has been used for hundreds of years, and I think that business men and Courts of Law have always interpreted it in one way, namely, that, if the only voyage mentioned is from the port of shipment to the port of destination, it must be a voyage on the ordinary track by sea of the voyage from one place to another."

The facts in the well-known case of *Scaramanga v. Stamp* (1880) were that one vessel encountered another in distress. There would have been no difficulty in taking off the crew from the distressed vessel, but instead of this an agreement was made for the one vessel to tow the other into port. On the way severe weather was encountered, and the tug with its cargo was lost. It was held that the deviation was unjustifiable, and that the shipowner was liable for the loss of the cargo, although, in fact, it occurred through perils of the sea which were excepted in the charter.

On the other hand, if the master acts reasonably and for a recognized exception deviates, he will not make the shipowners liable for loss, and need not communicate with the cargo owners if he acts for the best of all interests. A competent master will be allowed to exercise his discretion in choosing one port more than another to which to put back for repairs. (See *Phelps v. Hill* (1891).)

Control over and Care of the Cargo

Generally, as to the master's authority on the voyage as agent for the shipowners and as to the cargo, see Chapter II, and as to navigation, Chapter III of this Part.

During the voyage the owner of the goods retains authority over them, provided he has not parted with the document of title. He may, therefore, alter the destination of the goods if he issues his instructions in good time. Even where he has sold the goods, he may issue an order to stop delivery, provided they are still in transit, in a case where the buyer has become insolvent. (See Chapter VI of this Part, and as to the general right of *stoppage in transitu*, see Part III, Chapter VI.)

It is the duty of the master to take care of the goods and to prevent their loss and deterioration from any preventable cause on the voyage. A duty is imposed upon him, it has been said, as representing the shipowner to take reasonable care of the goods entrusted to him, not merely in doing what is necessary to preserve them on board the ship during the ordinary incidents of the voyage, but also in taking reasonable measures to check and arrest the loss, destruction, or deterioration by reason of accidents, for the necessary effects of which there is, by reason of the exceptions in the contract, no original liability. (As to the master's power of sale in certain cases, and to pledge by bottomry and respondentia, see Chapter II of this Part.)

If during the voyage the ship sustains injuries through excepted perils which make it impossible for her to proceed, or such delay would be incurred through necessary repairs that it is not worth continuing the voyage, the master may abandon the voyage. He may then tranship the goods and forward them by another vessel, and so earn the freight, or, on behalf of the charterer, forward the goods, abandoning the right to freight. The master is not perhaps bound to re-ship under such circumstances, but if he forwards the goods to their destination, he is entitled to the amount of freight as originally stipulated, although he may, in fact, have contracted for a smaller rate under the provisions for transhipment. Without authority, express or arising from necessity, he cannot bind the cargo owner to pay a higher rate. The master must, in brief, take care of the cargo,

so that, subject to the excepted perils, it may be delivered at its destination in good order and condition, if signed for as so received on board.

THE DELIVERY

The discharge of the ship must be at the port named in the bill of lading or charter-party. Discharge otherwise may be restrained. A charter-party may, however, leave the port uncertain, either to be named at the port of loading or later. In the latter case it must be named within a reasonable time. If discharge at the actual port is prevented by a permanent obstruction, the ship may usually discharge at a place "as near thereto as she can safely get", as port means a safe port, free from natural dangers to the ship or from political disturbance. The test is whether the ship could ordinarily reach the port "at all times of the tide always afloat", this term implying that the ship shall not go anywhere where she would ground. Cargo may therefore in some cases be discharged at as near a place as the depth of water and safety of the channel permit in fulfilment of a contract to deliver actually at the port. Mere temporary obstruction, however, is not sufficient, as in the case of an icebound port, a difficulty which may reasonably be anticipated at a certain time of year and the removal of which must be awaited.

The mode of discharge is usually subject to the practice of the port. It is generally the consignee's duty to take cargo from the ship's side, and such a delivery is a satisfactory discharge of the shipowner's duty.

The master is not bound to notify the arrival of the ship in port to the charterer or consignee, unless it is specially so provided. He must notify the Customs, but it is the duty of the cargo owner or consignee to watch for the ship and be ready to take delivery of his goods. The cargo owner is liable for landing and wharf charges. By contract the ordinary duty to deliver personally to the owner of the goods according to the custom of the port may be excused. The person generally entitled to delivery is the holder of the bill of lading, unless notice has been given to the master that such holder is not so. He is entitled to the goods described in the bill of lading according to the number and marks, but only after payment of freight, unless it is specially agreed otherwise. Before goods are delivered, the master will require to see either the bill of lading endorsed to the effect that freight has been paid, or the production of a freight release issued on behalf of the shipowner. When the cargo is made up of goods of the same description belonging to various owners, it often becomes mixed, and the marks get obliterated. The cargo must then be distributed in equal proportions according to the quantities shipped, in the absence of any express stipulation or custom.

It is the duty of the consignee to take delivery of the goods within a reasonable time, having regard to the nature of the goods and the custom of the port. Obviously a longer time must be allowed for the delivery of goods which are stowed below other goods. The discharge of cargoes of coal or grain is usually provided for in the charter. (And see "Demurrage", p. 63.)

Where the consignee of ordinary cargo imported into the United Kingdom fails to take delivery within a reasonable time of goods, the shipowner is entitled to land and warehouse them.

Where the consignee of any such goods fails to make entry of or to land them or take delivery with all convenient speed, the shipowner may make entry of the goods and land or unship the goods, either according to the time stipulated in the contract, or, if no time is stipulated, at any time after the expiration of seventy-two hours, excluding a Sunday or holiday, from the time the ship reported. Goods landed in this way must be placed by the shipowner in the wharf or warehouse named in the contract, if they can be conveniently received, or otherwise in some wharf or warehouse where such goods are usually received. The owner is entitled to take delivery before any such goods are actually landed or unshipped, and of goods landed for the convenience of the ship within twenty-four hours after assortment.

The shipowner by giving notice to the wharfinger or warehouseman retains a lien for freight or other charges on goods so landed. This lien is only discharged upon the production to the wharfinger or warehouseman of a receipt for the amount claimed and delivery of a copy or of a freight release from the shipowner, or by the deposit by the owner of the goods with the wharfinger or warehouseman of the amount due; in this case without prejudice to any other remedy which the shipowner may have for the recovery of freight.

The warehouseman has a right of sale by public auction if the lien is not discharged or no deposit is made within ninety days in the case of ordinary goods, or at an earlier period in his discretion in the case of perishable goods. Before the sale public advertisement must be given in the usual way, and the owner must be notified if his address

is known. The proceeds of sale are applied, in the order named, to payment of customs or excise duties, expenses of sale, warehousing charges, and shipowner's claim for freight and charges, the surplus, if any, to belong to the owner of the goods.

FREIGHT

"Freight" is properly the amount payable for the safe carriage of goods in a ship. The term is also applied, though not correctly, to payment made for the use of a ship, which really should be known by the name of "hire".

In the absence of any stipulation, it is implied that payment of freight shall be on delivery of the goods, or on readiness to deliver, at the proper place on payment of the proper charges. It follows, therefore, that freight cannot be claimed if the voyage is prevented, although the prevention is due to causes over which the shipowner has no control. Freight is not recoverable for an illegal voyage.

Freight is usually only payable on "goods" shipped, carried, and delivered; but it may be provided that freight shall be paid "ship lost or not lost".

In an old case, *Hunter v. Prinsep* (1808), Lord Ellenborough said: "The shipowners undertake that they will carry the goods to the place of destination, unless prevented by the dangers of the seas, or other unavoidable casualties: and the freighter undertakes that if the goods be delivered at the place of their destination, he will pay the stipulated freight; but it was only in that event, viz. of their delivery at the place of destination, that he, the freighter, engages to pay anything. If the ship be disabled from completing her voyage, the shipowner may still entitle himself to the whole freight by forwarding the goods by some other means to the place of destination; but he has no right to any freight if they be not so forwarded, unless the forwarding them be dispensed with, or unless there be some new bargain on this subject. If the shipowner will not forward them, the freighter is entitled to the goods without paying anything. . . . If no freight be earned and he (the shipowner) decline proceeding to earn any, the freighter has a right to the possession."

The same rule applies if goods have to be destroyed owing to their defective condition; but the shipowner has a right to goods which are delivered although damaged, the consignee having his claim for damages against the shipowner.

Lump freight secured under a charter-party is payable on delivery of the cargo, and disputes often arise when the whole of the cargo is not delivered. It is usual in such a case for the deadweight capacity of the vessel to be stated, and if the full cargo loaded shows less than the weight, the charterer is entitled to a reduction.

There may be an express, and in some cases an implied, agreement to pay the whole or part of the freight although the voyage is not actually completed. In the case of live animals payment may be provided for whether delivered alive or not.

Advance Freight

Where it is agreed that freight shall be payable in advance, in whole or part, and it is not paid as agreed on shipment, the advance freight must be paid though the ship and goods are lost. This is not the case, however, where a stipulation is to the effect that freight shall be paid in advance if required, and it is not so required until after the loss has taken place. In such a case the allowance for the insurance on advance freight has been held to show that the demand was to be made when insurance of the ship and cargo was possible. Advance freight is thus distinguished from a loan on account of freight.

Freight under agreement, which has been paid in advance, is not recoverable.

If a ship should be proved to have been unseaworthy at the time of sailing, which is a breach of an implied condition, and is afterwards lost, freight is not payable.

Time Freights

An agreed freight according to the time of the employment of the ship is in the nature of rent, and it is usually provided in what way this shall be calculated. Such freight, in the absence of stipulation, is payable on the discharge, and on such an agreement the time occupied in repairs is not deducted, unless it is so stipulated.

Freight is also payable (in the absence of stipulation to the contrary) during the detention of the ship by blockade, embargo, or other *force majeure*. It is usual, however, to provide for periodical payments, and to withdraw the ship on non-payment. If, however, the shipowner is going to take advantage of this, he must act promptly. He will not be allowed to delay notice of withdrawal until the ship has loaded and proceeded and then to claim damages, as he will be held to have waived his right under the contract.

In a recent case there was an exception in a time charter absolving both parties from carrying out the contract if strikes intervened, and the charterer ordered the ship to a port where it was known there was a strike and there was a delay of two months. It was held that the charterers were not entitled to refuse to pay hire, as they might have sent the ship to another port—*Brown v. Turner* (1912).

Even a time charter may be conditional on the carrying out of a certain voyage.

Calculation of Freight

Freight is payable at the rate stipulated in the bill of lading, or at the ordinary rate if not so stated, except in cases where there has been an express agreement to carry freight free or at a nominal rate. The mode of measurement or of ascertaining the weight is usually stated, but if not, and the weight varies as between the port of loading and the port of discharge, it is usual to take the lowest weight for the purpose of ascertaining freight, subject, however, to the custom of the trade. In grain and seed contracts it is usual to stipulate for shipping weights. It is, no doubt, customary in the case of goods which do not show any appreciable change to pay on the delivered weights. The bill of lading quantity, unless it is so agreed, is not conclusive against either party. The freight is taken to be payable in cash, without discount or allowance, subject, however, to customary allowances in certain cases. The cargo owner has no right to deduct from the freight the amount he claims for damage or loss, unless it is expressly agreed. It is usual to claim against the shipper on short delivery for the price of the goods at the time.

Payment of Freight

A common clause provides for payment with freight of primage and average according to any particular trade usage. "Primage" is a small percentage on the freight, which was originally the perquisite of the master, but now, if payable at all, it is usually agreed between the master and shipowner that it shall belong to the latter. "Average" in this connection indicates a share of certain expenses incurred, partly for the benefit of the ship and partly for the benefit of the cargo, such as towage.

Freight is payable by the person who agrees to pay under the contract, or, if not so named, by the person on whose behalf the goods were shipped, although he may only have been an agent. The original shipper remains liable even after delivery, but it is usual for shippers to be absolved under a clause in the bill of lading. When it plainly appears from the words of such a cesser clause that the parties intended all liability of the shipper to cease on loading he is absolved, whether a lien is given on the cargo or not. Usually such a lien is given in substitution of the right against the charterer.

The consignee in most cases pays the freight, and if credit is given to the consignee the right of recourse against the shipper is lost. The person who presents the bill of lading is in practice responsible and generally prepared, in the ordinary course of business, to pay the freight.

As to transfer of the bill of lading see p. 52.

Freight secured under a charter-party is payable by the charterer, except in cases where, under a cesser or lien and exemption clause, the shipowner has agreed to relieve the charterer of all liability after the goods are shipped.

Freight is primarily payable to the person named in the contract, who is usually the owner of the ship at the time.

Freight may be assigned apart from the ship, and if notice is given to the freighter he must pay to the assignee, and will not be excused by payment otherwise. If there has been an assignment and cross claims are made, the shipowner may interplead. Payment to the master or agent of the shipowner will usually be effectual, and, in the case of several owners, if made to the managing owner or the ship's husband. On the sale of the ship the right to freight passes to the purchaser, but only to a mortgagee on his taking possession.

"Back freight" is a term applied to the amount due to the shipowner where the cargo does not reach its destination owing to excepted perils, or where on arrival a merchant does not take delivery within a reasonable time, and expenses are rightly incurred. It is then the duty of the master, if he does not tranship, to deal with the cargo in the owner's interests, and he can recover his charges for so doing.

By English law, where the voyage is only partly accomplished, freight is only payable *pro rata* if an agreement to that effect is expressly made or can be implied from the circumstances. Such an agreement is not implied merely by the receipt of the goods by the owner at some intermediate port. Underwriters have the right to freight after the abandonment of the ship. (See Chapter IX of this Part.)

DEMURRAGE, ETC.

The charterer undertakes to deliver the goods to the ship within the time stipulated in the agreement. It is customary to allow so many days or hours for loading under the charter, and also for unloading, or to insert some such clause as "as fast as steamer can receive (or deliver) in the ordinary working hours", or a stipulation that so many tons are to be loaded or discharged per hour or day. These are the "lay" days or hours. It is then usually provided that there shall be certain additional days or hours for which the charterer shall pay a certain sum if the ship is delayed. This sum is properly called "demurrage". It is, however, customary to use the word demurrage as applied to damages in consequence of any detention of the ship beyond these days either for loading or discharging.

The lay days may be working days (of so many hours), which will exclude Sundays and holidays, or running days, meaning consecutive days, in which holidays will be included. Custom or usage of a particular port may, however, vary the interpretation of these expressions.

It is usual to treat the days for loading and discharge separately, but it may be provided in the charter that these shall be averaged, that is, if days are saved on the loading or on the discharge, they may be held to make good any days exceeded on the alternative operation. It is sometimes provided that "dispatch money" at so much per day or hour shall be paid to the charterer on time saved on loading or discharge.

Stipulations as to demurrage coming after the loading and discharge clauses apply to both loading and discharge.

If a time is fixed for the loading of the ship, this will impose an absolute obligation on the charterer to pay damages in any event for delay, unless he is expressly relieved owing to certain causes, such as frost, crowded port, &c. Under such a charter the charterer takes the risk of not being able to load in the stipulated time, and is liable in any event, except where the delay is due to the default of the shipowner, as where the ship is not sent to the proper place for loading. It follows also, from the fact that the liability of the charterer only begins when the ship arrives at the place prepared to load the cargo, that delay owing to quarantine falls on the shipowner, as the ship in the ordinary course has not then been placed at the disposal of the charterer.

If the work of loading or unloading is to be performed by an independent authority, such as a dock company, the charterer will not be liable for delay, unless it was in any way caused by his act.

Even in the case of exceptions they apply only to the port itself, as it is the charterer's duty to have the cargo ready. They will not excuse him for accidents at a distance, unless it is well understood or customary that cargo should be brought from a distance to a port, as where cargo is naturally stored higher up, and only brought down a river for shipment.

It is usual to stipulate in coal charters that the ship shall be ready to load "in regular turn". The charterer will be liable if the ship is ready and for some reason she does not get her turn.

Where it is stipulated that discharge shall be according to "settled or established practice and custom", and cargo is discharged with all dispatch according to the custom of the port, although the ship may be kept waiting even for some weeks, the charterer is not liable.

It is essential that notice should be given by the shipowner to the charterer of the ship's arrival at the port for loading before the lay days begin. Such notice is not necessary of the ship's arrival at the port of discharge, it being the duty of the charterer or his representative to watch the ship's progress.

Commencement of Lay Days

The lay days commence when the ship has arrived at the agreed place and is ready to take in or deliver cargo. The term "arrival of the ship" has been discussed in several important cases. It has been laid down that if the charter-party stipulates for a particular wharf, the ship must arrive alongside that wharf. If a particular dock is named, when the ship is ready and at the charterer's disposal inside the dock, although not alongside the quay, the ship has arrived, but the charterer may select the actual berth. If a port or other wide district is named, the ship has arrived when she is ready and at the charterer's disposal within the named place in its commercial sense, though she may not be in a position to receive or discharge cargo, or be at the wharf, dock, or other part of the place to which the charterer may have properly required her to go, for he can still select the actual loading spot. The charterer must act reasonably in his selection, and is liable in damages for delay in naming a berth. If the contract expressly entitled the charterer to order the ship to a particular wharf or dock, then the wharf or dock becomes the "particular place"

as named in the contract. If the ship is prevented from going to a particular place by obstacles caused by the charterer, the lay days begin as soon as the ship is ready and notice has been given to the charterer of that fact.

In the case of coaling charters it is usual for the charterer to stipulate for the loading to be according to Colliery Guarantee. He obtains from the colliery a guarantee to load so many tons a day or hour, and by incorporating the guarantee in his charter secures that he shall not be liable for any damages which he cannot recover against the colliery.

If the lay days are not fixed by the charter-party, but there is only such a term as "all dispatch", or "as fast as ship can deliver", the charterer must load or discharge with reasonable diligence after the ship has come to the agreed berth or port of delivery. A charterer is never liable for delay after the loading has been completed, as, for example, owing to the absence of ship's papers.

Demurrage under Bill of Lading

Demurrage usually arises under an agreement for the charter of a ship, but sometimes where bills of lading are given or negotiated to strangers to the charter-party, demurrage may be due to the action of the holder of the bill of lading. The bill of lading may contain a demurrage clause, or more commonly may incorporate the terms and conditions of the charter-party. It is usual to provide for the bill of lading holder paying demurrage at the port of loading. Liability, while primarily attaching to the shipper, passes on assignment of the bill of lading by endorsement.

Demurrage may arise in the case of a general ship. Each consignee is allowed a reasonable time to take delivery, and may have to pay for delay in taking delivery of his goods and so detaining the ship.

Right to Sue

The person who primarily has the right to sue for demurrage is the shipowner. When no lien is given, a charterer is still liable for demurrage and detention at the port of loading. The charterer is the person primarily liable, unless under the cesser clause it has been agreed that he shall not be liable under the charter-party after the shipment of the goods.

A master may sue if the contract was made by him.

Lien

At common law the shipowner has a lien on the cargo for freight, as he has a right to keep the goods till they are properly demanded and the charges are paid. This lien applies to the particular goods shipped, and depends on their possession. It is not a general lien covering other goods of the same shipper. Such a lien also applies to general average and expenses incurred in preserving or protecting the cargo, as well as freight.

It is usual to give an express lien by the charter-party, which then covers other charges, including dead freight, that is, damages for breach of covenant to load a full cargo. Without agreement there is no lien for advance freight, or where freight is payable before the delivery of goods or not due when goods are claimed. The right to lien may be waived expressly or impliedly by making freight payable after delivery.

Maritime lien, giving a claim against the ship, is independent of possession. It arises under salvage services, damages for collision and bottomry; and the master and seamen have such a lien on the ship for the payment of their wages (by statute). (See Chapter III of this Part.)

Lien does not cover a master's outlay for necessaries not secured, nor claims for towage; but, as we have seen, a warehouseman has, in certain cases where goods are landed, not only a lien but a right of sale.

Except when given by express words, there is no lien for demurrage, or damages for detention, or for dead freight, or for wharfage dues or charges.

(See "Lien" generally, Part III, Chapter XII.)

General Average

Where a loss arises to some part of the ship or cargo owing to an extraordinary sacrifice made or expenses incurred for the preservation of either the ship or cargo, this must be borne in proportions by all the parties interested. It is essential to "general average" that there should have been a common danger, and one not due to the default of one of the parties. There must have been both the necessity for a sacrifice and a voluntary sacrifice, involving an actual destruction, and there must be an actual saving through the sacrifice. The sacrifice may take the form either of a loss, as by jettison of cargo, or damage to goods through water being poured on the ship to put out fire, or loss by sale of the cargo or part of it for the purpose of providing supplies, or through cutting away some part of the ship or its tackle, or by loss of freight. On the other hand, there may be an extraordinary expenditure for time or labour and expenses in a port of refuge.

Where general average arises, it is the duty of

the master to collect the contributions from the various parties liable, and he must furnish accounts. He is entitled to retain the cargo until the contribution is paid. It is usual for the parties to execute a general average bond, agreeing to pay the amount found due on adjustment.

The parties usually liable to general average contribution are the shipowner, or in some cases the charterer, if there has been a demise, the cargo owner or consignee of cargo, and, where a bill of lading so stipulates, or a notice that the master's lien is given to the holder at the time, the holder of the bill of lading is liable.

Particular Average is when any damage is done to the ship or cargo which is not for the general benefit. Such loss falls upon the owner of the particular property. (See "Marine Insurance", Chapter IX of this Part.)

A Recent Case

A recent case in the House of Lords well illustrates many of the points which are dealt with in this Chapter. In *Kish v. Taylor* (1912), the owners of the S.S. *Wearside* sued the holders of bills of lading for part of a cargo of timber from Pensacola to Liverpool. The owners claimed a lien upon the cargo for loss sustained in consequence of the charterer's failure to load a complete cargo. The bill of lading incorporated all the conditions of the charter-party, which authorized deviation for the purpose of saving life and property, and gave an absolute lien on the cargo for all freight, dead freight, demurrage, and average. The charterers were bound to furnish a full cargo, which they failed to do, loading only about 801 instead of 1390 standards; the ship at the time being perfectly seaworthy and ready to receive a full cargo, and the owners being quite prepared to carry out their contract. The right to recover damages by way of dead freight therefore accrued at that time, but the master, after this default on the part of the charterers, obtained additional cargo from other sources. He, however, overloaded the ship with deck cargo to such an extent as to make her unseaworthy. Proceeding to sea, in consequence of bad weather and her overloaded condition, he was forced to take refuge in order to save his vessel and the lives of the crew. Although some of the deck cargo was carried overboard, other portions jettisoned, and others damaged, as well as the vessel herself, the owners made no claim for the cost of repairs or for compensating the owners of the lost or damaged cargo, frankly admitting their improper act in overloading the ship. The ship duly arrived in Liverpool with the original timber cargo uninjured.

The House of Lords decided that the shipowners were entitled to recover dead freight. Lord Atkinson, delivering their judgment, said it was not disputed that it was *prima facie* not only the right but the duty of the master to deviate if it were reasonably necessary in order to save his ship and the lives of his crew, nor was it in this case disputed that the owners were answerable in damages to everyone who sustained loss or injury by reason of the breach of their warranty of seaworthiness, and that they could not recover from any party for any loss or expense which was the result of their breach of warranty, or any course they might have had to take in consequence of it. In certain cases a voluntary or unwarranted deviation would render the contract of affreightment void *ab initio*, but justifiable deviation did not avoid the contract if it was the presence of the peril and not its causes which justified it. It became, therefore, immaterial whether the unseaworthiness of the ship or negligent navigation contributed directly to the peril or not. In the present case, therefore, the deviation was justifiable, and if it was the presence of the peril and not its causes which determined the character of the deviation, the contract was not void. Otherwise the master of a ship was left in such a dilemma that, whenever by his own culpable act or a breach of contract by his owner he found his ship in a perilous position, he must continue on his voyage at all hazards, or only seek safety under the penalty of forfeiture of the contract. Nothing could tend more to increase the dangers to which life and property were exposed at sea if it were held that the law of England obliged the master of a merchant ship to choose between such alternatives. In this case, in fact, the claim of the owners arose before they were in default at all, and was independent of their default, and due to the charterers' default. The latter were, in fact, seeking to take advantage of the owners' wrong to deprive them of a right which their own wrong gave them.

Lord Atkinson was of opinion that a master whose ship was from whatever cause in a perilous position did right in making such deviation from his voyage as was necessary to save his ship and the lives of his crew, and that while the right to recover damages for all breaches of contract and all wrongful acts committed either by himself or the owners was preserved to those who were wronged or injured, the contract was not put an end to by such deviation, nor were the rights of the owners under it lost.

CHAPTER VIII

SALVAGE AND WRECK

Salvage—Wreck

SALVAGE

Introductory

"Salvage" is the service performed by anyone who, as a volunteer and under no legal obligation to act in the particular matter, renders a useful service which is successful in salving a vessel or cargo.

Under the Maritime Conventions Act, 1911, a master or person in charge of a vessel is under a general duty to render assistance to persons in danger at sea, even if subjects of a State at war. Neglect is a misdemeanour. Compliance with this requirement does not affect the right to salvage.

A person who saves or assists in saving a ship or property belonging to a ship from danger at sea, who is not under a duty to the ship, is usually entitled to reward. In the ordinary way a master or crew cannot be salvors of their own ship, as they owe a duty to do their utmost for the ship. The owners of one vessel cannot claim salvage against another owned by them if as carriers they would be liable for loss or damage to the cargo. A pilot, while engaged as pilot, cannot ordinarily claim salvage. But a crew may, after abandonment of a vessel, become entitled for services subsequently rendered which assist in its recovery, or a pilot for exceptional assistance. A tug engaged to tow is not entitled to salvage, but for exceptionally dangerous services may be able to claim. A passenger also owes a duty to the ship in an emergency which usually prevents him from recovering as a salvor. Managing owners are rarely awarded salvage, as such duties are generally comprised in the services for which they are engaged.

It is essential that the service should be personal and successful in its object, that is, that goods should have been saved, and that the service rendered should have contributed to the saving. The onus of proof is upon those who allege they have rendered salvage services, and they must show there was a real and sensible danger or apprehension of it. The claim may be barred by custom or usage, or by agreement, or misconduct in the salvors.

"Salvage" includes all expenses properly incurred by the salvor in the performance of the salvage services.

The right to salvage is peculiar to the saving of property from danger at sea. There is no such right in connection with saving property on land, although the term "Salvage" is commonly applied to goods saved from fire.

Remuneration for Salvage

Where services are rendered wholly or in part within British waters in saving life from any British or foreign vessel, or elsewhere in saving life from any British vessel, the salvor is entitled to demand from the owner of the vessel, cargo, or apparel saved a reasonable amount of salvage. Salvage in respect of preservation of life payable by the owners of the vessel is payable in priority to all other claims for salvage. Where the vessel, cargo, or apparel is destroyed, or the value is insufficient to pay the amount of salvage payable in respect of preservation of life, in the discretion of the Board of Trade a sum may be payable out of public moneys.

Salvage may sometimes be awarded by British Courts in respect of foreign ships beyond the

British jurisdiction, as under Order in Council, when any foreign Government has agreed to this course, the provisions of the Merchant Shipping Act may be applied to such ships.

When services are rendered by any person other than the receiver of wreck in assisting a vessel or saving the cargo or apparel in or near the coasts of the United Kingdom, the salvor is entitled to a reasonable amount of salvage from the owners of the vessel, cargo, apparel, or wreck. Any agreement made as to the amount must be a fair one, or the Court will not uphold it.

In the assessment of salvage remuneration the Courts take many facts into consideration. They have been summarized by Lord Justice Buckley in a recent case: (1) The Court is generous in these matters, for this reason, that it is desirable to encourage salvage services. (2) In order to estimate the amount which is to be awarded, consideration is not given simply to the price at which such services could have been bought in the market. (3) Regard is to be had to the value of the ship salved and to the value of the salving ship, (4) to the danger to which each ship was exposed, (5) to the delay to which the salving vessel has been put, and (6) to the fact that the salving vessel has accepted a task for which she gets nothing if she fails—*The Port Hunter* (1910).

Determination of Salvage Disputes

Disputes as to the amount of salvage payable, whether for life or property, if not settled by agreement, arbitration, or otherwise, may be determined summarily: in any case where the parties consent; or where the value of the property does not exceed £1000; in any case where the amount claimed does not exceed in Great Britain £300, in Ireland £200. In all other cases disputes as to salvage are determined by the High Court in England and Ireland, and in Scotland by the Court of Session. If an action is brought and less than £300, or £200 in Ireland, is recovered, the claimant will usually be disentitled to costs.

Summary disputes are settled by County Courts having Admiralty jurisdiction, or in Scotland by the Sheriff's Court, in Ireland by two justices, a stipendiary, recorder, or chairman of Quarter Sessions. There is an appeal from the decision in cases summarily dealt with.

In any case of dispute the receiver of the district may, on the application of either party, value the property.

Where salvage is due to any person the receiver may detain the vessel or wreck, and in certain cases the receiver may sell such detained property for the purposes of satisfying the salvage claim.

A claim to salvage may be recovered by action against the owners to the extent of the value of property saved, but the salvor has a claim against the ship itself and also a lien upon the ship.

An agreement as to salvage where the salvor voluntarily agrees to abandon his lien may be made before two witnesses, and binds the ship and the cargo and freight and the respective owners for payment of salvage which may be adjudged by the Court.

When salvage has been awarded and does not exceed £200, the receiver may settle any dispute as to its apportionment amongst the several claimants. Where the amount exceeds £200, any dispute may be settled by the Admiralty Courts.

In disputes as to apportionment of salvage between owner or master, pilot or crew, in the service of a foreign vessel, the apportionment is in accordance with the law of the country to which the vessel belongs. (See also Chapter X of this Part.)

Salvage by H.M. Ships

Where salvage services are rendered by any of H.M. ships, the consent of the Admiralty is required to any prosecution of a claim for salvage.

Where salvage services are so rendered at any place out of the limits of the United Kingdom, the vessel, cargo, or property saved may be taken to some port where there is a consular officer or colonial Court of Admiralty; before such official or court a bond may be executed agreeing to answer the demand for salvage services.

Services Apart from Salvage

Claims for remuneration, apart from salvage, may be made against the owner if it can be shown that the services were requisitioned, as distinguished from being volunteered. Ordinarily, however, an agreement to pay for services in any event is not readily implied.

WRECK

"Wreck" includes jetsam, flotsam, lagan, and derelict found in or on the shores of the sea or any tidal water. Unidentifiable wreck belongs to the Crown, but owners may subsequently prove their title.

(As to enquiries into shipping casualties by

a Wreck Commissioner, see Chapter V of this Part.)

Duties of Receiver of Wreck

Where a British or foreign vessel is wrecked, stranded, or in distress at any place on the coast of the United Kingdom, or any tidal water, the receiver of wreck for the district, upon being acquainted with the circumstances, must proceed there and take command of all persons present, assign duties and give directions for the preservation of persons, cargo, and apparel of the vessel. Disobeying the receiver is an offence, but he must only interfere between the master and the crew in reference to the management of the vessel when he is requested to do so by the master. The receiver may require persons to assist him, require the master or other person in charge of any vessel near at hand to assist, and demand the use of any wagon, cart, or horses near at hand for the purpose of assisting such a vessel in distress. Power is given to use adjoining lands, the owner or occupier to be compensated for any damage.

The receiver may suppress any plunder and disorder by force. If such a vessel is plundered, damaged, or destroyed by persons riotously or tumultuously assembled together, compensation is to be made to the owner of the vessel, cargo, or apparel, in England as under the Riot (Damages) Act, 1886, by the local authority, in Scotland by the inhabitants of the county, city, or burgh, in Ireland as under the Malicious Injuries Act.

In the absence of a receiver his powers may be exercised (in the order named) by any chief officer of Customs, principal officer of the coastguard, officer of Inland Revenue, sheriff, justice of the peace, or naval or military commissioned officer.

Where any ship is or has been in distress on the coast of the United Kingdom, the receiver of wreck, or other appointed person, may examine any person belonging to the ship or other person as to the name and description of the ship, name of the master and owners, owners of the cargo, destination, occasion of distress, services rendered, and other matters.

Dealing with Wreck

Where any person finds or takes possession of any wreck within the limits of the United Kingdom, or any wreck found elsewhere is brought within those limits, if he is the owner he must give notice to the receiver of the district with a description; if he is not the owner, he must deliver the wreck to the receiver. Non-compliance with this requirement is subject to a penalty of £100 and forfeiture of any claim to salvage and payment of double value to the owner.

Where a vessel is wrecked, stranded, or in distress within the limits of the United Kingdom, any cargo or other articles belonging to or washed ashore must be delivered to the receiver; and any person, whether owner or not, guilty of secretion or appropriation is liable to a penalty.

A receiver must give notice within 48 hours that he has taken possession of any wreck by posting a description in the Customs House on the spot, and if the value exceeds £20, he must transmit a description to Lloyd's in London.

The owner of any wreck in possession of the receiver, upon establishing his claim within one year and paying the salvage fees and expenses, is entitled to have the wreck or the proceeds delivered up to him. In the case of any foreign ship, the Consul-General of the country to which the ship or cargo owners belong, in the absence of the owner or master or other agent, is deemed to be the agent of the owner for the purpose of the custody and disposal of the articles.

The receiver may effect an immediate sale of any wreck if it is under the value of £5, or of a damaged or perishable nature, or of insufficient value to pay for warehousing, the net proceeds being held by the receiver as if the wreck had remained unsold.

Unclaimed Wreck

The title to unclaimed wreck found in any part of His Majesty's dominions, except in places where the right has been granted to any other person, is in the Crown. Any person who is entitled in his own right to unclaimed wreck must deliver a statement of his title to the receiver of the district, and the receiver in possession of the wreck must within 48 hours send a full description to such person, if satisfied as to his title.

Where no owner establishes a claim to any wreck within one year after it came into a receiver's possession, the receiver must deal with the wreck; (*a*) if the wreck is claimed by a person entitled who has proved his title as required, it must, after payment of expenses, be delivered to him; (*b*) if not so claimed, the receiver must sell and pay the net proceeds either to the Duchy of Lancaster or the Duchy of Cornwall if so claimed, otherwise to the Crown. Disputed rights may be determined summarily as in the case of salvage.

The Board of Trade may purchase rights to a wreck possessed by any private person.

Removal of Wrecks

When any vessel is sunk, stranded, or abandoned in any water under the control of a harbour or conservancy authority, or in or near any approach, so as to cause obstruction or danger to navigation or lifeboats, the authority may take possession and remove, or light or buoy any such vessel; and they may sell any vessel or part raised or removed to cover the expenses, after giving due notice of sale and subject to the right of the owner before sale to have the property delivered to him on paying the fair market value. A general lighthouse authority for the district, where there is no harbour or conservancy authority, may deal with obstructions in the same way.

The decision of the Board of Trade in any dispute between authorities is final.

Receivers of Wrecks

Receivers of wrecks are appointed by the Board of Trade, and may be any officers of customs or of the coastguard, or of inland revenue or some other person. Fees are payable to receivers in accordance with regulations, and are recoverable as salvage dues. Coastguard officers are entitled to remuneration according to scale for services rendered in watching and protecting shipwrecked property.

Any wreck consisting of dutiable goods which comes ashore is liable to the ordinary customs duty.

Offences in Regard to Wrecks

It is a felony to take any wreck to a foreign port. A fine of £50 is imposed upon any person unlawfully interfering with any vessel wrecked, stranded, or in distress, or hindering the saving of any such vessel, secreting any wreck, or wrongfully carrying away any part of the vessel or the cargo. The receiver may take proceedings before justices against any person suspected of interference with any wreck.

Marine Store Dealers

For the prevention of the disposal of articles from wreck through the agency of marine-store dealers or old-metal dealers, stringent regulations are imposed upon such dealers. (See Part I, Chapter XIII.)

CHAPTER IX

MARINE INSURANCE

Introduction—The Subject-matter of the Law of Marine Insurance—Insurable Interest—Disclosures, Representations, and Warranties—Effect of Express Agreement and Usage—The Policy—The Premium—The Voyage—For what Losses the Insurer is Liable—Total Loss—Partial Loss, General and Particular Average, &c.—Suing and Labouring Clause—Indemnity—Miscellaneous—Stamps.

INTRODUCTION

When and where this practice of marine insurance first had its origin it is perhaps hopeless now to discover. But there seems to be good reason for believing that it was first introduced into England by the Lombards. Prior to the reign of Elizabeth it appears to have been but little known in this country. That reign, as we have had occasion to recall in other Parts of this Book, was marked by an enormous expansion in the national life and commerce of the country, and it is not inappropriate that we should find insurance as affecting commerce by sea then definitely recognized. In the forty-third year of Queen Elizabeth's reign an Act was passed for the establishing of a special Court for the trying of causes having to do with policies of insurance, and it would appear that this Court was subsequently held by the Court of King's Bench to have jurisdiction over no contracts of insurance which did not relate to commerce. The Court itself does not appear to have been a very great success, and at length fell into desuetude.

It was not till the time of Lord Mansfield, who became Chief Justice in 1756, however, that the law of marine insurance was definitely established as a part of the law of the country, and its principles collated and laid down with anything approaching the completeness of a system of law. That great judge not merely did much to amend the procedure of the Court and to make the remedies of law more easily available and effective for those interested in marine insurance, but, by his researches into other systems and the opinions of learned writers, as well as by his masterly exposition of the principles applicable to the cases which came before him for decision, he laid the real foundation of the law of marine insurance as we now know it.

With the growth of the overseas commerce of the country, the law of marine insurance has also grown. New facts have come forward to be adjudicated upon, and new conditions of things have arisen. At length in the year 1906 an Act was passed "to codify the Law relating to Marine Insurance". Such a statute could not, indeed, contain every principle or rule of law which must be called in aid for the decision of all the problems that arise in connection with the law of marine insurance. The law of this subject depends not merely on other statutory provisions, but also on principles of law which cannot be expressly dealt with and set out within the bounds of any statute. Like very much, too, of our commercial law, this law of marine insurance has grown up in great part out of the usages of merchants and insurers. And we find the Act expressly declaring that nothing contained in it, or in any repeal effected by it, is to affect certain statutes which it indicates, especially the Stamp Act, or the provisions of any statute not expressly repealed by it, and also that the rules of the common law including the law merchant, save in

so far as they are inconsistent with the express provisions of the Act, are to continue to apply to contracts of marine insurance.

History of Lloyd's

No view of the history of marine insurance in England would be complete without some reference to Lloyd's.[1] This great insurance corporation, or association of persons engaged in the practice of insurance, takes its name from Lloyd's Coffee House, which stood some two hundred years ago at the corner of Abchurch Lane in Lombard Street, and subsequently in Pope's Head Alley. It was the custom in those days for people having common interests—literary, political, or otherwise—to meet in coffee-houses, some of which have become historic. And the old Lloyd's Coffee House became a rendezvous or centre for persons interested in maritime business. It published its own gazette, and in course of time we find the business of underwriting so much focused there that its underwriters agreed as to the form of policy to be used. And to this day, although all the business of this sort that is done is not transacted at Lloyd's, Lloyd's forms and Lloyd's usages have to a remarkable extent set the fashion and passed into the common practice of marine insurance. Other than marine insurance is also transacted at Lloyd's. Its headquarters or domicile is now in the Royal Exchange buildings in the City of London, and here it gathers together and records information bearing on marine insurance from all parts of the globe. Its agents are to be found all over the world. Lloyd's was only incorporated by statute in 1871. (See also Part I, Chapter X.)

The law of marine insurance is both wide and complicated, which is, indeed, not surprising, as, like very much of commercial law, the law of marine insurance has grown up gradually, and has been moulded largely by the customs and the requirements of those concerned in the business to which it relates.

Practice at Lloyd's

But if the law on the subject is complex, uniformity of practice, at least, to a great extent prevails, and this is very much due to the place occupied and the influence enjoyed by Lloyd's. That this association should have set the fashion as it has, and that the forms and usages of Lloyd's should have moulded and become so much a part of the common practice of marine insurance in England, is not surprising if one has regard to its length of standing and the enormous interests which it stands for. In a society of insurers, where personal qualifications are looked to, and where the interests of both insurer and assured are commonly represented on both sides by those who are members of the same body, it is not unnatural that credit and the obligations of honour should play a great part in the transaction of business. As a result, certain obligations are regarded at Lloyd's as binding in honour which are not actually binding in a legal sense.

For the proper understanding of the terms which are employed in marine insurance, and the law upon the subject, it is necessary to know something of the manner in which the effecting of an insurance is actually carried out, and the following is a rough sketch of the usual method of insuring at Lloyd's.

The merchant who desires to insure a mercantile venture having requested his broker to insure it at Lloyd's, the broker writes upon a "slip" a short note of the outlines of the risk which he desires the underwriters to undertake. This slip he places before the underwriter, or, it may be, the person who "writes" for a group or syndicate of underwriters, and if such person approves of the risk he initials the slip, and writes opposite his initials the amount for which he is willing to become liable as an insurer. In all probability no one underwriter or group of underwriters is willing to undertake the whole liability, and in this case the person initialing the slip sets down the amount for which he, or the syndicate for which he writes, is willing to be responsible. On a large risk very many individual underwriters may be liable, each possibly for only a very small proportion of the total liability.

The effect and the character of this document or slip was described in the following terms by Mr. Justice Blackburn in the case of *Ionides v. Pacific Insurance Company* (1871): "The slip is, in practice, and according to the understanding of those engaged in marine insurance, the complete and final contract between the parties, fixing the terms of the insurance and the premium, and neither party can, without the assent of the other, deviate from the terms thus agreed on without a breach of faith, for which he would suffer severely in his credit and future business".

But although the slip is regarded as binding in honour, it is usually followed by the execution of a formal policy. Indeed, by the Stamp Act, 1891, modified by the Finance Act, 1901, a contract for sea insurance is, with certain exceptions, not valid unless it is expressed in a policy of sea insurance, and a policy of sea insurance must for its validity satisfy certain statutory requirements. The

[1] See Arnould, *Marine Insurance.*

Marine Insurance Act, 1906, likewise lays down certain statutory requirements as essential to the validity or the admissibility in evidence of the contract as the case may be. It has apparently, on more than one occasion, been considered by judges that the slip was something essentially different from a policy. And, in the case already referred to, Mr. Justice Blackburn went on to say that the slip might be given in evidence wherever it was, though not valid, material. Having regard to the provisions of the Stamp Act, 1891, and of the Marine Insurance Act, 1906, and also to the terms of the judgments of the Court of Appeal in *Home Marine Insurance Company v. Smith* (1898), it may now be considered possible that the slip itself may be stamped and sued upon as a policy if it contains all the particulars and satisfies all the conditions required by the statutes in the case of a policy. If the true view be that a slip may itself be a policy, can it be given in evidence in every case in which it was previously considered that it might be referred to, supposing that a policy in the more conventional sense is afterwards executed? By Section 89 of the Marine Insurance Act, 1906, when there is a duly stamped policy, reference may be made, "as heretofore", to the slip or covering note in any legal proceeding. The question remains, accordingly, "as heretofore". Probably the section would be construed as authorizing the slip to be referred to in the wider manner. At all events, it is expressly laid down by Section 21 of the Marine Insurance Act, 1906, that for the purpose of showing when the proposal was accepted, reference may be made to the slip or covering note or other customary memorandum of the contract, although it be unstamped.

Where the broker does not know whether the principal for whom he acts would be willing to accept the only terms upon which the broker can get the risk underwritten, the slip is sometimes made out subject to approval.

Floating Policies

It is sometimes convenient for the assured to arrange with the underwriter for the latter to underwrite up to a certain amount, leaving the assured subsequently to appropriate the insurance to a particular subject-matter of insurance or particular subject-matters. For example, a merchant engaged in a particular trade may desire to have the protection of insurance available for cargoes up to a certain value before he is able to identify the particular consignments which go to make up the total amount of the goods. Accordingly it is left for him to declare subsequently the particular subject-matters to which he wishes the policy to attach.

Open Cover

An arrangement of an even more general and indeterminate character is becoming, it is believed, increasingly common. By this arrangement, under the name of an "open cover", the underwriter agrees to underwrite all the risks put forward in a certain period by a particular assured of a certain description, or, at all events, up to a certain amount. This agreement may or may not be reduced to writing, and may not even be intended as more than an honourable engagement entered into by the respective parties. It is generally, if not always, understood by the underwriter that he is to be offered all such work that the assured has to offer, and that if there is a breach of this understanding on the part of the assured, the underwriter is to be at liberty to throw up his part of the arrangement. In any case, there is frequently a term that either party may determine the arrangement on giving a certain notice of his intention so to do. Under this general agreement separate policies are taken out from time to time during its existence. But it is to be observed that, although the amount to be insured on any one risk may be limited in amount, there is no limitation in the ordinary case upon the total amount so insured during the period on the whole of the policies together.

Insurance Companies

Important as are the place and influence of Lloyd's in the practice of marine insurance, it does not, of course, enjoy a monopoly of such insurances.

Many of the general insurance companies now include marine insurance in their undertakings. At one time the privilege of insuring marine risks was confined by law to certain companies, but this is no longer the case. To part, at least, of the ordinary course of insurance business as transacted by such companies, much of what has been already said applies. Frequently the first memorandum of the insurance which a company intends to effect is a slip in the form already described. And a slip which is initialed by individual underwriters may also be so initialed on behalf of a company. But very commonly a memorandum called a "covering note" provisionally acknowledging the arrangement represented by the slip is issued by the company, subsequently to the slip and preparatory to the formal policy. Whether this document could ever be stamped and sued on

Photo. Pictorial Agency

LLOYD'S REGISTER

Photo. Pictorial Agency

UNDERWRITERS' ROOM, LLOYD'S

as itself constituting a policy is a question which would seem to raise very much the same considerations as have already been suggested in regard to the slip.

THE SUBJECT-MATTER OF THE LAW OF MARINE INSURANCE

The Marine Insurance Act, 1906, deals not merely with contracts to indemnify against losses incident to marine adventure, but also with contracts to indemnify against losses on inland waters or any land risk which may be incidental to a sea voyage, when, by its express terms or by usage of trade, a contract of marine insurance is extended to cover such losses. And the terms of the Act, so far as applicable, apply to ships in course of building, or the launch of a ship or any adventure analogous to a marine adventure, when covered by a policy in the form of a marine policy.

Except where otherwise expressly provided, every lawful marine adventure may be the subject of a contract of marine insurance, and in particular where ships, goods, or other moveable property are exposed to maritime perils they may be the subject of such insurance; and so may the earning or acquisition of any freight, passage money, commission, profit, or other pecuniary benefit which is endangered by the exposure of any of the above-mentioned property to maritime perils, or the security for any advances, loan, or disbursements so endangered. And where the owner of, or other person interested in or responsible for, any such property as has been mentioned may incur liability to a third party by reason of maritime perils, such liability may be the subject of marine insurance.

Under the head of maritime perils come perils consequent on or incidental to the navigation of the sea, that is to say, perils of the seas, fire, war perils, pirates, rovers, thieves, captures, seizures, restraints, and detainments of princes and peoples, jettisons, barratry, and any other perils either of the like kind or which may be designated by the policy.

INSURABLE INTEREST

To render the insurance valid, the assured must have an insurable interest—that is to say, he must be interested in the marine adventure concerned; and he is so interested, in particular, if he stands in any legal or equitable relation to the adventure, or to any insurable property which is at risk in the adventure, of such a character that he may benefit by the safety or due arrival of insurable property, or may be prejudiced if it is lost or damaged or detained, or may incur liability in respect of it. (See also Part III, Chapter XIX.)

It is not necessary that the assured should have this interest at the time when the insurance is effected, but he must have it at the time when the loss occurs. If, however, the insurance was made subject to the qualification "lost or not lost", the assured may recover, although he may not have acquired his interest until after the loss has occurred, unless at the time of effecting the insurance the assured was aware that the loss had occurred, and the insurer had not this knowledge. But where the qualification "lost or not lost" does not exist, nothing that the assured can do after learning of the loss can give him the interest which is necessary to support the insurance.

It is to be observed that when it is said that the assured must have an insurable interest, this does not imply that he must be solely interested. On the contrary, any partial interest may be insured. So may interests which are defeasible or only contingent in their character; in particular, when the buyer of goods has insured them, the insurance is not invalidated by the fact that he might, had he chosen to stand on his rights, have rejected the goods, or have treated them as being at the seller's risk, owing to the latter's delay in delivery or for some other reason.

The Act expressly recognizes the different sorts of interest of persons standing in various relations to the subject-matter insured. The lender of money on bottomry or respondentia has an insurable interest in respect of the loan. So has the master or any member of the crew of a vessel in respect of his wages. And when freight is paid in advance, the person advancing the freight has such an interest, in so far as such freight is not repayable in case of loss. The assured himself may insure the charges of his own insurance, whilst the insurer may re-insure elsewhere the risk which he undertakes in insuring. But unless it is otherwise provided in the policy, the original assured has no right or interest in respect of such re-insurance.

In the case of the subject-matter insured being subject to a mortgage, the mortgagor has, for the purpose of insurance, an interest equal to the full value of the subject-matter of insurance, whilst the mortgagee has an insurable interest in respect of any sum due or to become due under the mortgage.

Where a third person has agreed or is liable to indemnify the owner of insurable property in case of loss, this fact does not cut down the owner's insurable interest.

A mortgagee, consignee, or other person having an interest in the subject-matter insured, may insure on behalf of and for the benefit of other persons interested, as well as for his own benefit.

Want of Interest

Where, however, the assured has no interest within the meaning of the Act, and contracts without any expectation of acquiring such an interest, the insurance is void, being treated on the same footing as a marine insurance by way of gaming or wagering. And the same applies to any term such as "interest or no interest", "without further proof of interest than the policy itself" (p.p.i.), or "without benefit of salvage to the insurer", with this proviso, that where there is no possibility of salvage, a policy may be effected without benefit of salvage to the insurer. See below as to such a policy being effected by a person in the employment of the owner of a ship and who is not a part owner.

It is expressly provided by the Act that where a contract of marine insurance is effected in good faith by one person on behalf of another, the latter may ratify the contract even after he is aware of a loss. (See also Part III, Chapter II.)

Gambling Policies

Whilst by the Marine Insurance Act, 1906, contracts of marine insurance by way of gaming or wagering are null and void, certain contracts are by the Marine Insurance (Gambling Policies) Act, 1909, to be deemed to be contracts by way of gambling on loss by maritime perils, and the person effecting such contracts is made guilty of an offence and is liable, subject to certain formalities and provisions, to imprisonment or fine, and to forfeit to the crown any money he may receive under the contract. Such contracts are:—

(*a*) Where any person effects a contract of marine insurance without having any *bona fide* interest, direct or indirect, either in the safe arrival of the ship in relation to which the contract is made, or in the safety or preservation of the subject-matter insured, or a *bona fide* expectation of acquiring such an interest.

(*b*) Where any person in the employment of the owner of a ship, not being a part owner of the ship, effects a contract of marine insurance in relation to the ship, and the contract is made "interest or no interest", or "without further proof of interest than the contract itself", or "without benefit of salvage to the insurer", or subject to any other like term.

Any broker or other person through whom, and any insurer with whom, any such contract is effected is also guilty of an offence, and liable to the like penalties if he acted knowing that the contract belonged to either of the classes mentioned.

If proceedings under the Act of 1909 are taken against any person (other than a person in the employment of the owner of the ship in relation to which the contract was made) for effecting such a contract, and the contract was made subject to any term such as is mentioned in paragraph (*b*) above, the burden is thrown on the accused of proving that the contract was not one by way of gambling on loss by maritime perils.

Assignment of Interest

Apart from transmission of interest by operation of law, the assured does not, by assigning his interest in the subject-matter insured, transfer to the assignee his rights under the contract of insurance, unless there is an express or implied agreement with the assignee to this effect.

DISCLOSURES, REPRESENTATIONS, AND WARRANTIES

It must be borne in mind that a contract of marine insurance is one in which the utmost good faith is required, or, as it is sometimes expressed, it is a contract *uberrimae fidei*. If the utmost good faith is not observed by either party, the other party may, if he so wish, regard the contract as avoided or made of no effect.

Disclosures

If the assured fails to make such disclosures to the insurer as it is his duty to make, the insurer is entitled to avoid the contract. The following circumstances (and the term "circumstance" here includes any communication made to, or information received by, the assured) need not be disclosed unless enquiry is made:—

(*a*) Any circumstance which diminishes the risk.

(*b*) Any circumstance which is known or presumed to be known to the insurer. The insurer is presumed to know matters of common notoriety

or knowledge, and matters which an insurer in the ordinary course of his business as such ought to know.

(*c*) Any circumstance as to which information is waived by the insurer.

(*d*) Any circumstance which it is superfluous to disclose by reason of any express or implied warranty.

With these exceptions, the disclosures which it is the duty of the assured to make to the insurer, before the contract is concluded, include every material circumstance which is known to the assured; and he is deemed to know every circumstance which, in the ordinary course of business, ought to be known by him. Whether any particular circumstance which is not disclosed is material or not is a question of fact in each case. A circumstance is material for this purpose which would influence the judgment of a prudent insurer in fixing the premium or determining whether he will take the risk.

In a recent case circumstances affecting the previous career of the master were held not material, but the concealment of the fact of over-insurance and the existence of "p.p.i." policies were held to void the contract.—*Thames & Mersey Marine Insurance Company v. Gunford Ship Company* (1911).

When an insurance is effected for the assured through an agent, then, subject to what has just been said as to circumstances which need not be disclosed, the agent must disclose to the insurer, in the first place, every material circumstance which is known to himself, and for this purpose an agent to insure is deemed to know every circumstance which in the ordinary course of business ought to be known by, or to have been communicated to him, and, in the second place, every material circumstance which the assured is bound to disclose, unless it come to his knowledge too late to communicate it to the agent.

Representations

The law is strict, also, with regard to representations made before the contract is effected. Every material representation made by the assured or his agent to the insurer during the negotiations for the contract, and before the contract is concluded, must be true; otherwise the insurer may avoid the contract. Whether any particular representation is material or not is a question of fact in each case. It is material if it would influence the judgment of a prudent insurer in fixing the premium or determining whether he will take the risk. A representation may be either as to a matter of fact or as to a matter of expectation or belief. If the representation is as to a matter of fact, it is true if it be substantially correct, that is to say, if the difference between what is represented and what is actually correct would not be considered material by a prudent insurer. A representation as to a matter of expectation or belief is true if it be made in good faith. A representation may be withdrawn or corrected before the contract is concluded.

Conclusion of Contract

A contract of marine insurance is deemed to be concluded when the proposal of the assured is accepted by the insurer, whether the policy be then issued or not. For the purpose of showing when the proposal was accepted, reference may be made to the slip or covering note or other customary memorandum of the contract, although it be unstamped.

Warranties

The use of the word "warranty" is familiar in marine insurance as applied to a proviso or exception subject to which the contract is to be construed. An instance of this use of the word is to be found in the "free from particular average" or "F.P.A." memorandum, limiting the scope of the insurance contained in the policy. But the term is also very commonly applied to what is called in the Act a "promissory" warranty, that is to say, a warranty by which the assured undertakes that some particular thing shall or shall not be done, or that some condition shall be fulfilled, or whereby he affirms or negatives the existence of a particular state of facts. In relation to warranties in this latter sense, the Act contains the following provisions:—

The warranty may be express or implied, but it is a condition which must be exactly complied with, whether it be material to the risk or not. If it be not so complied with, then, subject to any express provision in the policy, the insurer is discharged from liability as from the date of the breach of warranty, but without prejudice to any liability incurred by him before that date.

Where the warranty has been broken, it is no excuse to say, on the part of the assured, that the breach has been remedied and the warranty complied with before the loss occurred. The breach may, nevertheless, be waived by the insurer, and non-compliance with a warranty is excused when, by reason of a change of circumstances, the warranty ceases to be applicable to the circumstances of the contract, or when compliance with the warranty is rendered unlawful by any subsequent law.

Express Warranties

No particular form of words is required to constitute an express warranty, so long as the intention to warrant is to be inferred from those actually used. It must, however, be included in, or written upon, the policy, or must be contained in some document incorporated by reference with the policy. An express warranty does not exclude an implied warranty, unless it be inconsistent with it.

Instances of express warranties are warranties as to the date of sailing, as to the restrictions in regard to the voyage to be undertaken, as to the character of the voyage, or as to neutrality of the subject-matter.

Where insurable property, whether ship or goods, is expressly warranted neutral, there is an implied condition that the property shall have a neutral character at the commencement of the risk, and that, so far as the assured can control the matter, its neutral character shall be preserved during the risk. And in the case of a ship being expressly warranted "neutral" there is also an implied condition that, so far as the assured can control the matter, she shall be properly documented, that is to say, that she shall carry the necessary papers to establish her neutrality, and that she shall not falsify or suppress her papers or use simulated papers. If any loss occurs through breach of this condition, the insurer may avoid the contract.

There is no implied warranty as to the nationality of a ship, or that the nationality shall not be changed during the risk.

When the subject-matter insured is warranted "well" or "in good safety" on a particular day, it is sufficient if it be safe at any time during that day.

Implied Warranties

Warranties are sometimes implied as to the character or condition of the ship herself. In a voyage policy there is an implied warranty that at the commencement of the voyage the ship shall be seaworthy for the purpose of the particular adventure insured. (See also Chapter VI of this Part.) Where the policy relates to a voyage which is performed in different stages, during which the ship requires different kinds of or further preparation or equipment, there is an implied warranty that at the commencement of each stage the ship is seaworthy in respect of such preparation or equipment for the purposes of that stage. In the case of a policy attaching while the ship is in port, a warranty is also implied that she shall, at the commencement of the risk, be reasonably fit to encounter the ordinary perils of the port. According to the Act, a ship is deemed to be seaworthy when she is reasonably fit in all respects to encounter the ordinary perils of the seas of the adventure insured. But it is to be noted that in a time policy no warranty is implied that the ship shall be seaworthy at any stage of the adventure, although, where, with the privity of the assured, the ship is sent to sea in an unseaworthy state, the insurer is not liable for any loss attributable to unseaworthiness.

There is no implied warranty in a policy on goods or other moveables that the goods or moveables are seaworthy, but in a voyage policy on goods or other moveables there is an implied warranty that at the commencement of the voyage the ship is not only seaworthy as a ship, but also that she is reasonably fit to carry the goods or other moveables to the destination contemplated by the policy.

A warranty is implied as to the legality of the adventure insured, and that, so far as the assured can control the matter, the adventure shall be carried out in a lawful manner.

EFFECT OF EXPRESS AGREEMENT AND USAGE

The effect of express agreement or of usage is to be borne in mind in regard to the rights, duties, or liabilities that would be implied by law under a contract of marine insurance, for it is provided in the Act of 1906 that any such right, duty, or liability may be negatived by express agreement, or by usage, if the usage be such as to bind both parties to the contract. This applies also to any right, duty, or liability declared by the Act which may be lawfully modified by agreement.

THE POLICY

With some exceptions[1] the contract of insurance must be embodied in a policy in order to be admissible in evidence, and the policy must specify—

(1) The name of the assured, or of some person who effects the insurance on his behalf;

See p. 71.

(2) The subject-matter insured and the risk insured against;

(3) The voyage, or period of time, or both, as the case may be, covered by the insurance;

(4) The sum or sums insured;

(5) The name or names of the insurers.

The policy must be signed by or on behalf of the insurer, except in the case of a corporation, when the corporate seal may be sufficient, though the Act makes no special requirement on the point. In the absence of anything to the contrary, there is a separate contract between the assured and each insurer subscribing the policy.

The subject-matter insured must be designated in a marine policy with reasonable certainty. The nature and extent of the interest of the assured in the subject-matter insured need not be specified in the policy. Where the policy designates the subject-matter insured in general terms, it is construed to apply to the interest intended by the assured to be covered. In this connection regard is had to any usage regulating the designation of the subject-matter insured.

Different Kinds of Policies

A policy may be either valued or unvalued, and it may be either a "time policy" or a "voyage policy", or by its terms it may be both a "voyage policy" and a "time policy". Where it is agreed to insure "at and from", or from one place to some other place or places, the policy is called a "voyage policy", and when the insurance is for a definite period of time, the policy is called a "time policy". Although a time policy for any time exceeding twelve months is invalid, nevertheless by Section 11 of the Finance Act, 1901, it may contain an agreement, known as a "continuation clause", providing to the following or the like effect, that in the event of the ship being at sea or the voyage otherwise not completed on the expiration of the policy, the subject-matter shall be held covered until the arrival of the ship, or for a reasonable time thereafter not exceeding thirty days. A policy containing this clause is chargeable with an extra stamp duty of sixpence, and also if the risk covered by the continuation clause attaches and a new policy is not issued covering the risk, the policy must be stamped as if it were a new and separate contract of insurance; but this may be done without penalty at any time not exceeding thirty days after the risk has so attached.

A valued policy is one which specifies the agreed value of the subject-matter insured, and this value is, as between the insurer and the assured, subject to the provisions of the Act of 1906 and in the absence of fraud conclusive both in cases of total and partial loss, of the insurable value of the subject-matter intended to be insured. But, unless the policy otherwise provides, this agreed value is not conclusive for the purpose of determining whether there has been a constructive total loss.

Floating Policies

The Act of 1906 expressly recognizes floating policies, in which the insurance is described in general terms, and the name of the ship or ships and other particulars are left to be defined by subsequent declaration, which may be done by endorsement on the policy or in some other customary way. But unless the policy provides otherwise, the declarations must be made in the order of dispatch or shipment, and in the case of goods must comprise all consignments within the terms of the policy, the value of the goods or other property being honestly stated, though an omission or erroneous declaration if made *bona fide* may be rectified even after loss or arrival. But when a declaration of value is not made until after notice of loss or arrival, then, unless otherwise provided, the policy is to be treated as an unvalued policy as regards the subject-matter of that declaration.

The following form of policy, though not obligatory, is authorized by the Marine Insurance Act, 1906.

Form of Policy

BE IT KNOWN THAT as well in own name as for and in the name and names of all and every other person or persons to whom the same doth, may, or shall appertain, in part or in all doth make assurance and cause and them, and every of them, to be insured, lost or not lost, at and from

Upon any kind of goods and merchandises, and also upon the body, tackle, apparel, ordnance, munition, artillery, boat, and other furniture, of and in the good ship or vessel called the whereof is master under God, for this present voyage, or whosoever shall go for master in the said ship, or by whatsoever other name or names the said ship, or the master thereof, is or shall be named or called; beginning the adventure upon the said goods and merchandises from the loading thereof aboard the said ship,

upon the said ship, &c.

and so shall continue and endure, during her abode there, upon the said ship, &c. And further, until the said

ship, with all her ordnance, tackle, apparel, &c., and goods and merchandises whatsoever shall be arrived at

upon the said ship, &c., until she hath moored at anchor twenty-four hours in good safety; and upon the goods and merchandises, until the same be there discharged and safely landed. And it shall be lawful for the said ship, &c., in this voyage, to proceed and sail to and touch and stay at any ports or places whatsoever

without prejudice to this insurance. The said ship, &c., goods and merchandises, &c., for so much as concerns the assured by agreement between the assured and assurers in this policy, are and shall be valued at

Touching the adventures and perils which we the assurers are contented to bear and do take upon us in this voyage: they are of the seas, men-of-war, fire, enemies, pirates, rovers, thieves, jettisons, letters of mart and countermart, surprisals, takings at sea, arrests, restraints, and detainments of all kings, princes, and people, of what nation, condition, or quality soever, barratry of the master and mariners, and of all other perils, losses, and misfortunes that have or shall come to the hurt, detriment, or damage of the said goods and merchandises, and ship, &c., or any part thereof. And in case of any loss or misfortune it shall be lawful to the assured, their factors, servants, and assigns, to sue, labour, and travel for, in and about the defence, safeguards, and recovery of the said goods and merchandises, and ship, &c., or any part thereof, without prejudice to this insurance; to the charges whereof we, the assurers, will contribute each one according to the rate and quantity of his sum herein assured. And it is especially declared and agreed that no acts of the insurer or insured in recovering, saving, or preserving the property insured shall be considered as a waiver, or acceptance of abandonment. And it is agreed by us, the insurers, that this writing or policy of assurance shall be of as much force and effect as the surest writing or policy of assurance heretofore made in Lombard Street, or in the Royal Exchange, or elsewhere in London. And so we, the assurers, are contented, and do hereby promise and bind ourselves, each one for his own part, our heirs, executors, and goods to the assured, their executors, administrators, and assigns, for the true performance of the premises, confessing ourselves paid the consideration due unto us for this assurance by the assured, at and after the rate of

In WITNESS whereof we, the assurers, have subscribed our names and sums assured in London,

N.B.—Corn, fish, fruit, flour, and seed are warranted free from average, unless general, or the ship be stranded—sugar, tobacco, hemp, flour, hides and skins are warranted free from average, under five pounds per cent, and all other goods, also the ship and freight, are warranted free from average, under three pounds per cent, unless general, or the ship be stranded.

Explanation of Terms in above Form of Policy

For the construction of a policy in the above or a like form the following rules are given by the Act, subject to the provisions of the Act and when the context does not otherwise require:—

1. Where the subject-matter is insured "lost or not lost", and the loss has occurred before the contract is concluded, the risk attaches unless at such time the assured was aware of the loss, and the insurer was not.

2. Where the subject-matter is insured "from" a particular place, the risk does not attach until the ship starts on the voyage insured.

3. (*a*) Where the ship is insured "at and from" a particular place, and she is in that place in good safety when the contract is concluded, the risk attaches immediately.

(*b*) If she be not at that place when the contract is concluded, the risk attaches as soon as she arrives there in good safety, and, unless the policy otherwise provides, it is immaterial that she is covered by another policy for a specified time after arrival.

(*c*) Where chartered freight is insured "at and from" a particular place, and the ship is at that place in good safety when the contract is concluded, the risk attaches immediately. If she be not there when the contract is concluded, the risk attaches as soon as she arrives there in good safety.

(*d*) Where freight, other than chartered freight is payable without special conditions and is insured "at and from" a particular place, the risk attaches *pro rata* as the goods or merchandise are shipped; provided that if there be cargo in readiness which belongs to the shipowner, or which some other person has contracted with him to ship, the risk attaches as soon as the ship is ready to receive such cargo.

4. Where goods or other moveables[1] are insured "from the loading thereof", the risk does not attach until such goods or moveables are actually on board, and the insurer is not liable for them while in transit from the shore to the ship.

5. Where the risk on goods or other moveables continues until they are "safely landed", they

[1] "Moveables" in the Act means any moveable tangible property, other than the ship, and includes money, valuable securities, and other documents.

must be landed in the customary manner and within a reasonable time after arrival at the port of discharge, and if they are not so landed the risk ceases.

6. In the absence of any further license or usage, the liberty to touch and stay "at any port or place whatsoever" does not authorize the ship to depart from the course of her voyage from the port of departure to the port of destination.

7. The term "perils of the seas" refers only to fortuitous accidents or casualties of the seas. It does not include the ordinary action of the winds and waves.

8. The term "pirates" includes passengers who mutiny and rioters who attack the ship from the shore.

9. The term "thieves" does not cover clandestine theft or a theft committed by any one of the ship's company, whether crew or passengers.

10. The term "arrests, &c., of kings, princes, and people" refers to political or executive acts, and does not include a loss caused by riot or by ordinary judicial powers.

11. The term "barratry" includes every wrongful act wilfully committed by the master or crew to the prejudice of the owner, or, as the case may be, the charterer.

12. The term "all other perils" includes only perils similar in kind to the perils specifically mentioned in the policy.

13. The term "average unless general" means a partial loss of the subject-matter insured other than general average loss, and does not include "particular charges".

14. Where the ship has stranded, the insurer is liable for the excepted losses, although the loss is not attributable to the stranding, provided that when the stranding takes place the risk has attached and, if the policy be on goods, that the damaged goods are on board.

15. The term "ship" includes the hull, materials and outfit, stores and provisions for the officers and crew, and, in the case of vessels engaged in a special trade, the ordinary fittings requisite for the trade, and also, in the case of a steamship, the machinery, boilers, and coals and engine stores, if owned by the assured.

16. The term "freight" includes the profit derivable by a shipowner from the employment of his ship to carry his own goods or moveables, as well as freight payable by a third party, but does not include passage money.

17. The term "goods" means goods in the nature of merchandise, and does not include personal effects or provisions and stores for use on board.

In the absence of any usage to the contrary, deck cargo and living animals must be insured specifically, and not under the general denomination of goods. (Generally, see also Chapter VI of this Part.)

THE PREMIUM

Payment

Unless it is agreed otherwise, the insurer is not bound to issue the policy until the premium is paid or tendered, for the duty of the assured or his agent to pay the premium and the duty of the insurer to issue the policy to the assured or his agent are concurrent conditions.

Where the marine policy is effected on behalf of the assured by a broker, the broker is, in the absence of any agreement otherwise, directly responsible to the insurer for the premium. The rule as to payment in respect of losses or in respect of returnable premiums is different, for the insurer is directly responsible to the assured for such payments.

But whilst the broker is liable, in the absence of any agreement, for the payment of the premiums, he has, on the other hand, a lien on the policy for the premium and his charges in respect of effecting the policy, and if he has dealt with the person who employs him as a principal and when the debt was incurred had no reason to believe that such employer was only an agent, he has a lien on the policy in respect of any insurance account which may be due to him from such person.

Where a marine policy effected on behalf of the assured by a broker contains a receipt for the premium, the receipt is, in the absence of fraud, conclusive as between the insurer and the assured, but not as between the insurer and the broker.

Where the insurance has been made, and it has been agreed that a premium shall be paid, or that an additional premium shall be payable on an event which has happened, but no arrangement has been actually made, then a reasonable premium or additional premium is payable. What is a reasonable premium is a question of fact.

Return of Premium

The premium may be returnable in certain circumstances to the assured. This may be so by agreement, where the policy contains a stipulation that the premium, or a proportionate part, shall be returned on the happening of a certain event,

and this event happens. In such a case either the whole or the proportionate part, as the case may be, is returnable to the assured. But the premium may also be returnable apart from any special agreement where the consideration for the payment of it totally fails, and there has been no fraud or illegality on the part of the assured or his agents. And similarly, if the consideration for the payment of the premium is apportionable, and there is a total failure of any apportionable part of the consideration, a proportionate part of the premium is, when there has been no fraud or illegality on the part of the assured or his agents, returnable to the assured. The Act lays down the following particular rules:—

(*a*) Where the policy is void, or is avoided by the insurer as from the commencement of the risk, the premium is returnable, provided that there has been no fraud or illegality on the part of the assured; but if the risk is not apportionable, and has once attached, the premium is not returnable;

(*b*) Where the subject-matter insured, or part thereof, has never been imperilled, the premium, or, as the case may be, a proportionate part thereof, is returnable:

Provided that where the subject-matter has been insured "lost or not lost", and has arrived in safety at the time when the contract is concluded, the premium is not returnable unless, at such time, the insurer knew of the safe arrival;

(*c*) Where the assured has no insurable interest throughout the currency of the risk, the premium is returnable, but this rule does not apply to a gaming or wagering policy;

(*d*) Where the assured has a defeasible interest which is terminated during the currency of the risk, the premium is not returnable;

(*e*) Where the assured has overinsured under an unvalued policy, a proportionate part of the premium is returnable;

(*f*) Subject to the foregoing provisions, where the assured has over-insured by double insurance, a proportionate part of the several premiums is returnable:

Provided that, if the policies are effected at different times, and any earlier policy has at any time borne the entire risk, or if a claim has been paid on the policy in respect of the full sum insured thereby, no premium is returnable in respect of that policy. When the double insurance is effected knowingly by the assured no premium is returnable.

THE VOYAGE

When the policy specifies the voyage which is to be undertaken, and to which the risks insured against relate, it is highly important to the effect of the contract of insurance to see that the voyage actually undertaken satisfies the description contained in the policy. A departure even in one particular from the specification in the policy may absolve the insurer from responsibility in regard to the whole or a part of the adventure actually undertaken. When the policy specifies a certain place as the place of departure, and the ship sails from any other place instead of the place specified, the risk does not attach. Where the subject-matter is insured by a voyage policy "at and from" or "from" a particular place, although it is not necessary that the ship should be at that place when the contract is concluded, the Act declares that there is an implied condition that the adventure shall be commenced within a reasonable time, and that if the adventure be not so commenced the insurer may avoid the contract. But this implied condition may be negatived either by showing that the delay was caused by circumstances known to the insurer when the contract was concluded, or by showing that he waived the condition.

Where the destination is specified by the policy, and the ship, instead of sailing for that destination, sails for any other destination, the risk does not attach. Where, after the commencement of the risk, the destination of the ship is voluntarily changed from the destination contemplated by the policy, there is said to be a change of voyage, and, unless the policy otherwise provides, the insurer is discharged from liability as from the time of change, that is to say, as from the time when the determination to change it is manifested; and this is so even if the ship has not, as a matter of fact, at the time of the loss occurring, left the course of voyage which was contemplated by the policy.

Deviation

Although the ship may not have transgressed the contract either in respect of the beginning or the end of the voyage, she may, nevertheless, injuriously affect the insurance by deviation from the voyage contemplated by the policy or by delay in prosecuting it. (See also Chapter VII of this Part.) There is a deviation from the voyage contemplated by the policy:

(*a*) Where the course of the voyage is specifically designated by the policy, and that course is departed from; or

(*b*) Where the course of the voyage is not specifically designated by the policy, but the usual and customary course is departed from.

The intention to deviate is not material; to discharge the insurer from his liability under the contract there must be a deviation in fact.

Unless there is lawful excuse for such deviation, the result of it is to discharge the insurer from liability as from the time of the deviation, nor does the fact of the ship regaining her course before any loss occurs mend matters in favour of the assured.

A deviation may occur in the case of there being several ports of discharge. Where several such ports are specified by the policy, the ship may go to all or any of them, but she must go to them, or such of them as she does go to, in the order designated by the policy, if there is no usage or sufficient cause to the contrary. Otherwise there is a deviation. Where the policy is to "ports of discharge" within a given area, which are not named, she must, in the absence of any usage or sufficient cause to the contrary, go to them, or such of them as she does go to, in their geographical order. Otherwise there is a deviation.

Delay

In the case of a voyage policy, the adventure insured must be prosecuted throughout its course with reasonable dispatch, and, if without lawful excuse it is not so prosecuted, the insurer is discharged from liability as from the time when the delay becomes unreasonable.

The Act provides that deviation or delay in prosecuting the voyage contemplated by the policy shall be excused in the following cases:—

(*a*) Where authorized by any special term in the policy; or

(*b*) Where caused by circumstances beyond the control of the master and his employer; or

(*c*) Where reasonably necessary in order to comply with an express or implied warrantry; or

(*d*) Where reasonably necessary for the safety of the ship or subject-matter insured; or

(*e*) For the purpose of saving human life, or aiding a ship in distress where human life may be in danger; or

(*f*) Where reasonably necessary for the purpose of obtaining medical or surgical aid for any person on board the ship; or

(*g*) Where caused by the barratrous conduct of the master or crew, if barratry be one of the perils insured against.

But when the cause excusing the deviation or delay ceases to operate, the ship must resume her course and prosecute her voyage, with reasonable dispatch.

FOR WHAT LOSSES THE INSURER IS LIABLE

It is to be observed that the sum insured does not necessarily represent the full amount for which the insurer may be liable under the policy, and it is expressly provided by the Act that, subject to the terms of the policy itself and the provisions of the Act, the insurer is liable for successive losses even although they may amount to more than the sum actually insured. But where, under the same policy, a partial loss, which has not been repaired or otherwise made good, is followed by a total loss, the assured can only recover in respect of the total loss. These provisions do not affect the liability of the insurer under the suing and labouring clause (see p. 85).

Generally speaking, in the absence of any special provision in the policy, the insurer is only liable for losses which are proximately caused by perils insured against. Some particular exceptions to the general rule as to liability are given in the Act. The insurer is not liable for a loss attributable to the wilful misconduct of the assured, but, on the other hand, it is no defence that the loss would not have occurred but for the misconduct or negligence of the master or crew if it was proximately caused by a peril insured against. Unless otherwise provided by the policy, an insurer on ship or goods is not liable for any loss proximately caused by delay, although the delay itself may be caused by a peril insured against. And similarly, if not otherwise provided by the policy, the insurer is not liable for ordinary wear and tear, ordinary leakage and breakage, inherent vice or the nature of the subject-matter insured, or for any loss proximately caused by rats or vermin, or for any injury to machinery not proximately caused by maritime perils.

TOTAL LOSS

A loss may be total or partial, and a total loss may be either an actual total loss or a constructive total loss; and a total loss in either sense is included in an insurance against total loss, unless a different intention appears in the terms of the policy.

Actual Total Loss

There is an actual total loss if the subject-matter insured is destroyed, or so damaged as to cease to be a thing of the kind insured, or where the assured is irretrievably deprived of it, and an actual total loss may be presumed where the ship is missing and, after a reasonable time, no news of her has been received.

Constructive Total Loss

The case of a constructive total loss is more complicated.

Subject to any express provision in the policy, there is a constructive total loss where the subject-matter insured is reasonably abandoned on account of its actual total loss appearing to be unavoidable, or because it could not be preserved from actual total loss without an expenditure which would exceed its value when the expenditure had been incurred.

In particular, there is a constructive total loss—

(i) Where the assured is deprived of the possession of his ship or goods by a peril insured against, and it is unlikely that he can recover the ship or goods, or the cost of recovering the ship or goods would exceed their value when recovered; or

(ii) In the case of damage to a ship, where she is so damaged by a peril insured against that the cost of repairing the damage would exceed the value of the ship when repaired. In estimating the cost of repairs, no deduction is to be made in respect of general average contributions to those repairs payable by other interests, but account is to be taken of the expense of future salvage operations and of any future general average contributions to which the ship would be liable if repaired; or

(iii) In the case of damage to goods, where the cost of repairing the damage and forwarding the goods to their destination would exceed their value on arrival.

In the case of a constructive total loss the assured has the option of treating the matter as a partial loss or abandoning the subject-matter insured to the insurer and claiming as for a total loss.

Notice of Abandonment

It is to be noted that, with certain exceptions, in order to claim as for a total loss, the assured must give notice of abandonment. Such notice is unnecessary where, at the time when the assured receives information of the loss, there would be no possibility of benefit to the insurer if notice were given to him, or where notice is waived by the insurer. And where the insurer has re-insured his risk, he is not required to give notice of abandonment to his re-insurer.

The notice may be given in writing, or by word of mouth, or partly in writing and partly by word of mouth, and it may be given in any terms which indicate the intention of the assured to abandon his insured interest unconditionally to the insurer. It must be given with reasonable diligence after receiving reliable information of the loss, but if the information is of a doubtful character, the assured is allowed a reasonable time to enquire. The abandonment is made irrevocable by acceptance of the notice, which has the effect of admitting both liability for the loss and the sufficiency of the notice. Although mere silence on the part of the insurer after receiving notice does not of itself constitute an acceptance, an acceptance may be implied from his conduct. If the notice is properly given, the fact that the insurer refuses to accept the abandonment does not prejudice any rights the assured may have.

The necessity for notice of abandonment does not arise in the case of an actual total loss.

Effect of Abandonment

A valid abandonment has the effect of entitling the insurer to take over the interest of the assured in what may remain of the subject-matter insured, and all proprietary rights incidental thereto. It has the effect, in the case of the abandonment of a ship, of giving the insurer a right to the freight in course of being earned, and which is earned by her subject to the casualty causing the loss, less the expenses of earning it incurred after the casualty. In the case of the owner's goods being carried by the ship, the insurer is entitled to a reasonable remuneration for the carriage of them after the casualty causing the loss.

PARTIAL LOSS, GENERAL AND PARTICULAR AVERAGE, ETC.

The total loss of the subject-matter insured, as has been already indicated, is not the only circumstance which may impose on the insurer a liability to pay. He may be liable for partial loss of the subject-matter, either from a part being wholly lost, or from part or the whole suffering deterioration, in each case through a peril insured against. He may even be under a liability to pay in certain cases in respect of expenses which do not represent a loss or injury actually suffered by the subject-matter itself. (See also Chapter VII of this Part.)

Particular and General Average Loss

The terms particular average loss and general average loss are somewhat confusing, and are specially dealt with in the Act. A particular average loss is defined as a partial loss of the subject-matter insured, caused by a peril insured against, which is not a general average loss. A general average loss is a loss caused by or directly consequential on a general average act, and it includes both a general average expenditure and a general average sacrifice. As a general average loss is defined by reference to a general average act, it is important to see what constitutes the latter, which exists where any extraordinary sacrifice or expenditure is voluntarily and reasonably made or incurred in time of peril for the purpose of preserving the property imperilled in the common adventure.

General Average Contribution

As between the parties interested in the adventure, there is an important distinction between particular and general average. For when there is a general average loss, the party on whom it falls is entitled, subject to the conditions imposed by maritime law, to a rateable contribution from the other parties interested. This is called a general average contribution. Such being the position of the assured towards those who are interested with him in the adventure, the insurer may in his turn be affected through the assured having incurred a general average expenditure, or having made a general average sacrifice, or through the assured having paid or being liable to pay a general average contribution.

Unless otherwise expressly provided in the policy, where the assured has incurred a general average expenditure he may recover from the insurer in respect of the proportion of the loss which falls upon him, and in the case of a general average sacrifice he may recover from the insurer in respect of the whole loss without having enforced his right of contribution from the other parties liable to contribute. On payment of the loss, however, the underwriter himself, on the principle of subrogation, becomes entitled to the rights of the assured to contribution (p. 87). Where the assured has paid, or is liable to pay, a general average contribution in respect of the subject insured, he may, unless it is otherwise expressly provided in the policy, recover in respect of it from the insurer. But it is to be noted that, in the absence of express stipulation, the insurer is not liable for any general average loss or contribution where the loss was not incurred for the purpose of avoiding, or in connection with the avoidance of, a peril insured against. The same assured may himself be the owner of ship, cargo, and freight, or of two out of these interests, and in such a case the liability of the insurer in respect of general average losses or contributions is to be determined as if those subjects were owned by different persons.

Particular Charges

It is to be observed that particular average, above referred to, does not include particular charges, a term which is applied to expenses incurred by or on behalf of the assured for the safety or preservation of the subject-matter insured, other than general average and the salvage clauses about to be mentioned. This is important when the policy excludes particular average either wholly or below a particular percentage. The expenses of services in the nature of salvage rendered by the assured or his agents, or any person employed for hire by them, for the purpose of averting a peril insured against, may, if properly incurred, be recovered as particular charges under the suing and labouring clause or as a general average loss, according to the circumstances under which they were incurred.

Salvage Charges

Salvage charges, on the other hand, are defined as meaning the charges recoverable under maritime law by a salvor independently of contract, and charges of this nature may, subject to any express provision in the policy, if they were incurred in preventing a loss by perils insured against, be recovered as a loss by those perils. (See also Chapter VIII of this Part.)

General Average Adjustment

Although the general principle of general average establishes clearly enough that the loss to the individual whose goods are sacrificed or whose money is expended for the benefit of the rest is to be compensated according to the loss sustained on the one hand and the benefit derived on the other, under the conditions already referred to, nevertheless, where a case for general average contribution exists, it is sometimes a matter of much difficulty and nicety to determine how the general average loss is to be borne. The fixing of the various contributions to be made by the various interests which are liable to contribute is known as general average adjustment, and the practice of adjustment is a sort of science in itself in the hands of average adjusters, and these adjusters have a more or less recognized practice and more or less recognized usages and rules for their common guidance. The practice is not indeed the same for the average adjusters of all countries, a fact which has given rise to considerable complications from time to time. Thus not merely may the practice of adjusters in two countries differ as to what is or is not a general average loss at all, but, even when a general average loss exists, the apportionment of the loss according to the average adjusters of one country may differ from that which would be made according to the recognized practice in another country. Consequently very different results may arise according to the place in which the adjustment is made. This place would generally, in the absence of any express stipulation on the point, be the port of the ship's destination or delivery of her cargo when there is only one such port of destination or delivery. It may, in certain cases, be some other place; for example, when the ship is forced to turn back at the beginning of the voyage and break up her voyage at the port of departure, this port may be the proper place in which to have the average adjustment made. But in any case those who are liable to contribute to the general average loss or expenditure are, unless it is otherwise agreed, liable to have the general average adjusted at the usual and proper place and according to the usage and law of that place. It is, of course, open to those concerned to agree that the matter shall be dealt with in some particular way, and if such a stipulation is inserted in the contract of affreightment it would be binding, at all events as between the parties to the contract, though whether persons interested in the adventure other than the shipowner and shipper would be bound by the stipulation may possibly depend on circumstances. (See also Chapter VI of this Part.) Something has been done towards securing uniformity in international practice by the formulating of the York–Antwerp Rules, which it is very common to incorporate, in whole or in part, in contracts of affreightment. They are the result of various international congresses on the subject, and of several conferences of the Society for the Reform and Codification of the Law of Nations.

Primarily, no doubt, the question of average adjustment is one that concerns those actually concerned in the adventure. But the underwriter is obviously concerned also, as has been shown. If the policy is silent as to his liability in respect of an adjustment made abroad, the general rule is that he is bound by such an adjustment if the place at which it has been made was the proper place for the purpose and if it has been made according to the law of that place, if the general average loss has been incurred or the general average expenditure has been made in order to avert a peril insured against, or at all events in connection with the avoidance of such a peril.

Various special clauses have been introduced into policies for the purpose of specially providing for the case of a foreign adjustment, such as "to pay general average as by foreign statement, if so made up". The effect of such a clause may be to render the insurer liable to indemnify the assured in respect of matters which would not properly be included under the head of general average according to English law at all, and even in respect of matters which were not caused by any of the perils named in the policy. The new clause given in the Institute Clauses runs as follows: "General average and salvage to be adjusted according to the law and practice obtaining at the place where the adventure ends, as if the contract of affreightment contained no special terms upon the subject; or if the contract of affreightment so provides, according to York–Antwerp Rules, or in the case of wood cargoes, York–Antwerp Rules omitting the first word of Rule I ('No'); but, in all matters not specifically referred to in York–Antwerp Rules I to XVII inclusive, the adjustment shall be in accordance with the law and practice obtaining at the place where the adventure ends, and as if the contract of affreightment contained no special terms upon the subject".

SUING AND LABOURING CLAUSE

The meaning of the ordinary suing and labouring clause was well explained by Mr. Justice Willes in *Kidston v. Empire Insurance Company* (1866) as follows: "If an occasion should occur in which, by reason of a peril insured against, unusual labour and expense are rendered necessary to prevent a loss for which the underwriters would be answerable, and such labour and expense is incurred accordingly, the underwriters will contribute, not as part of the sum insured in case of loss or damage, because it may be that a loss or damage for which they would be liable is averted by the labour bestowed, but as a contribution on their part as persons who have avoided detriment by the result in proportion to what they would have had to pay if such detriment had come to a head for want of timely care."

It is the duty of the assured and his agents in every case to take all reasonable measures in order to avert or minimize a loss. Under a suing and labouring clause, where the policy contains one, all expenses which have been properly incurred by the assured pursuant to the clause, may be recovered by him from the insurer quite apart from any sum which would otherwise be payable under the policy. The clause is effective for this purpose even though the insurer may have paid for a total loss, so that the insurer may be liable in certain cases to pay more than the sum for which the insurance is made, for the suing and labouring clause is deemed to be supplementary to the contract of insurance. Nor is it any objection to the operation of the clause that the policy warranted the subject-matter free from particular average, either altogether or under a certain percentage. But the loss for the averting or diminishing of which the expenses have been incurred must be one covered by the policy, and general average losses and salvage charges as defined cannot be recovered under the clause.

INDEMNITY

A policy of marine insurance is, in the main, a contract of indemnity, although, as has been judicially said, it is not a contract of perfect indemnity. This fact has a very important bearing on the question of the amount recoverable under the policy. The amount recoverable on a loss on a policy depends on a variety of circumstances, such as the fixed or unfixed value of the subject-matter, the amount of the loss, the amount for which the insurance is made, and the existence of other insurances on the same subject-matter.

Measure of Indemnity

The term "measure of indemnity" is applied to the sum which the assured can recover in respect of a loss on a policy by which he is insured, in the case of an unvalued policy to the full extent of the insurable value, or, in the case of a valued policy, to the full extent of the value fixed by the policy. The liability for this indemnity may be distributed over more policies than one, and in cases of under-insurance, i.e. where the assured is insured for an amount less than the insurable value, or, in the case of a valued policy, for an amount less than the value fixed by the policy, the assured is himself to be reckoned as one of the insurers for the purpose of determining the amount of the loss which is to be borne by the different insurers, as if he were his own insurer to the extent of the uninsured balance of the fixed or insurable value as the case may be.

Again, the assured may be over-insured by double insurance, where two or more policies are effected by him or on his behalf on the same adventure and interest or any part thereof, and the sums insured exceed the indemnity which he is allowed to receive, and special rules apply to such cases (see p. 87).

Statutory Rules as to Measure of Indemnity

The Act contains express rules as to the measure of indemnity.

Subject to its provisions and to any express provision in the policy, where there is a total loss of the subject-matter insured:—

1. If the policy be a valued policy, the measure of indemnity is the sum fixed by the policy.

2. If the policy be an unvalued policy, the measure of indemnity is the insurable value of the subject-matter insured.

Where a ship is damaged, but not totally lost, the measure of indemnity, subject to any express provision in the policy, is as follows:—

1. Where the ship has been repaired, the assured is entitled to the reasonable cost of the repairs, less the customary deductions, but not exceeding the sum insured in respect of any one casualty;

2. Where the ship has been only partially repaired, the assured is entitled to the reasonable cost of such repairs, computed as above, and also to be indemnified for the reasonable depreciation, if any, arising from the unrepaired damage, provided that the aggregate amount shall not exceed the cost of repairing the whole damage, computed as above;

3. Where the ship has not been repaired, and has not been sold in her damaged state during the risk, the assured is entitled to be indemnified for the reasonable depreciation arising from the unrepaired damage, but not exceeding the reasonable cost of repairing such damage, computed as above.

Subject to any express provision in the policy, when there is a partial loss of freight, the measure of indemnity is such proportion of the sum fixed by the policy in the case of a valued policy, or of the insurable value in the case of an unvalued policy, as the proportion of freight lost by the assured bears to the whole freight at the risk of the assured under the policy.

Where there is a partial loss of goods, merchandise, or other moveables, the measure of indemnity, subject to any express provision in the policy, is as follows:—

Where part of the goods, merchandise, or other moveables insured by a valued policy is totally lost, the measure of indemnity is such proportion of the sum fixed by the policy as the insurable value of the part lost bears to the insurable value of the whole, ascertained as in the case of an unvalued policy;

Where part of the goods, merchandise, or other moveables insured by an unvalued policy is totally lost, the measure of indemnity is the insurable value of the part lost, ascertained as in case of total loss;

Where the whole or any part of the goods or merchandise insured has been delivered damaged at its destination, the measure of indemnity is such proportion of the sum fixed by the policy in the case of a valued policy, or of the insurable value in the case of an unvalued policy, as the difference between the gross sound and damaged values at the place of arrival bears to the gross sound value;

"Gross value" means the wholesale price, or, if there be no such price, the estimated value, with, in either case, freight, landing charges, and duty paid beforehand; provided that, in the case of goods or merchandise customarily sold in bond, the bonded price is deemed to be the gross value. "Gross proceeds" means the actual price obtained at a sale where all charges on sale are paid by the sellers.

Where different species of property are insured under a single valuation, the valuation must be apportioned over the different species in proportion to their respective insurable values, as in the case of an unvalued policy. The insured value of any part of a species is such proportion of the total insured value of the same as the insurable value of the part bears to the insurable value of the whole, ascertained in both cases as provided by the Act.

Where a valuation has to be apportioned, and particulars of the prime cost of each separate species, quality, or description of goods cannot be ascertained, the division of the valuation may be made over the net arrived sound values of the different species, qualities, or descriptions of goods.

Subject to any express provision in the policy, where the assured has paid, or is liable for, any general average contribution, the measure of indemnity is the full amount of such contribution, if the subject-matter liable to contribution is insured for its full contributory value; but, if such subject-matter be not insured for its full contributory value, or if only part of it be insured, the indemnity payable by the insurer must be reduced in proportion to the under-insurance, and where there has been a particular average loss which constitutes a deduction from the contributory value, and for which the insurer is liable, that amount must be deducted from the insured value in order to ascertain what the insurer is liable to contribute.

Where the insurer is liable for salvage charges, the extent of his liability must be determined on the like principle.

Where the assured has effected an insurance in express terms against any liability to a third party, the measure of indemnity, subject to any express provision in the policy, is the amount paid or payable by him to such third party in respect of such liability.

Where there has been a loss in respect of any subject-matter not expressly provided for in the foregoing provisions of the Act, the measure of indemnity is ascertained, as nearly as may be, in accordance with those provisions.

Nothing in the provisions of the Act relating to the measure of indemnity affects the rules relating to double insurance, or prohibits the insurer from disproving interest wholly or in part, or from showing that at the time of the loss the whole or any part of the subject-matter insured was not at risk under the policy.

Warranty Free from Particular Average

It is very common to find in policies a provision

that certain things are warranted free from particular average, either altogether or from particular average below a certain percentage.

Where the subject-matter insured is warranted free from particular average, the assured cannot recover for a loss of part, other than a loss incurred by a general average sacrifice, unless the contract contained in the policy be apportionable; but, if the contract be apportionable, the assured may recover for a total loss of any apportionable part.

Where the subject-matter insured is warranted free from particular average, either wholly or under a certain percentage, the insurer is nevertheless liable for salvage charges, and for particular charges and other expenses properly incurred pursuant to the provisions of the suing and labouring clause in order to avert a loss insured against.

Unless the policy otherwise provides, where the subject-matter insured is warranted free from particular average under a specified percentage, a general average loss cannot be added to a particular average loss to make up the specified percentage.

For the purpose of ascertaining whether the specified percentage has been reached, regard is had only to the actual loss suffered by the subject-matter insured. Particular charges and the expenses of and incidental to ascertaining and proving the loss must be excluded.

MISCELLANEOUS

Double Insurance

Double insurance has been already referred to, and the Act contains the following rules with regard to it:—

(*a*) The assured, unless the policy otherwise provides, may claim payment from the insurers in such order as he may think fit, provided that he is not entitled to receive any sum in excess of the indemnity allowed by the Act;

(*b*) Where the policy under which the assured claims is a valued policy, the assured must give credit as against the valuation for any sum received by him under any other policy without regard to the actual value of the subject-matter insured;

(*c*) Where the policy under which the assured claims is an unvalued policy, he must give credit, as against the full insurable value, for any sum received by him under any other policy;

(*d*) Where the assured receives any sum in excess of the indemnity allowed by the Act, he is deemed to hold such sum in trust for the insurers, according to their right of contribution among themselves.

Although the assured may claim from the insurers in any order he thinks fit, nevertheless, as between himself and the other insurers, each insurer is bound to contribute rateably to the loss in proportion to the amount for which he is liable under his contract; and if any insurer pays more than his proportion of the loss, he is entitled to maintain an action for contribution against the other insurers, and to the like remedies as a surety who has paid more than his proportion of the debt. (See Part III, Chapter VIII.)

Mutual Insurance

Where two or more persons mutually agree to insure each other against marine losses, the provisions of the Act are modified in some respects. The provisions of the Act relating to the premium do not apply to mutual insurance, but a guarantee, or such other arrangement as may be agreed upon, may be substituted for the premium. The provisions of the Act, in so far as they may be modified by the agreement of the parties, may, in the case of mutual insurance, be modified by the terms of the policies issued by the association, or by the rules and regulations of the association. Otherwise the provisions of the Act apply to insurance of this nature.

Subrogation

It has been already pointed out that the contract of marine insurance is in the main one of indemnity, and the insurer is accordingly entitled to certain rights of subrogation, that is, in certain circumstances to stand in the shoes of the assured. The Act contains the following express provisions:—

Where the insurer pays for a total loss, either of the whole or, in the case of goods of any apportionable part, of the subject-matter insured, he thereupon becomes entitled to take over the interest of the assured in whatever may remain of the subject-matter so paid for, and he is thereby subrogated to all the rights and remedies of the assured in and in respect of that subject-matter as from the time of the casualty causing the loss.

Subject to the foregoing provisions, where the insurer pays for a partial loss, he acquires no title to the subject-matter insured, or such part of it as may remain, but he is thereupon subrogated to all rights and remedies of the assured in and in respect of the subject-matter insured as from the

time of the casualty causing the loss, in so far as the assured has been indemnified, according to the Act, by such payment for the loss.

Assignment

A marine insurance policy is assignable unless its own terms expressly prohibit its being assigned. The assignment may be made by an endorsement on the policy itself or in some other customary manner, and the assignment may be made either before or after a loss has occurred.

Save as regards assignments after loss, any assignment is inoperative, if made after the assured has parted with or lost his interest in the subject-matter insured, unless he has, before or at the time of parting with or losing his interest, expressly or impliedly agreed to assign the policy.

The assignee of a policy which has been assigned so as to pass the beneficial interest in it is entitled to sue on it in his own name. But the defendant is entitled to make any defence arising out of the contract which he would have been entitled to make if the action had been brought in the name of the person by or on behalf of whom the policy was effected.

General Principles

Whilst the special rules of law affecting marine insurance are, in great part at least, codified by the Act of 1906, still many of the principles which affect such contracts are not expressly set out in the Act itself, as has already been remarked (p. 70).

Besides such provisions as are common to insurance companies with other companies, the Companies (Consolidation) Act, 1908, contains certain provisions with regard to a statement to be made at certain times with regard to capital, &c., in the case of certain companies and societies, amongst which companies carrying on the business of insurance are included. (See Part III, Chapter IV.)

STAMPS

The Stamp Act, 1891, deals at some length with the revenue duties payable in the case of marine insurance. The expression "policy of insurance" includes every writing whereby any contract of insurance is made or agreed to be made, or is evidenced, and the expression "insurance" includes assurance.

The expression "policy of sea insurance" means any insurance (including re-insurance) made upon any ship or vessel, or upon the machinery, tackle, or furniture of any ship or vessel, or upon any goods, merchandise, or property of any description whatever on board of any ship or vessel, or upon the freight of, or any other interest which may be lawfully insured in or relating to, any ship or vessel, and includes any insurance of goods, merchandise, or property for any transit which includes not only a sea risk, but also any other risk incidental to the transit insured from the commencement of the transit to the ultimate destination covered by the insurance.

Where any person, in consideration of any sum of money paid or to be paid for additional freight or otherwise, agrees to take upon himself any risk attending goods, merchandise, or property of any description whatever while on board of any ship or vessel, or engages to indemnify the owner of any such goods, merchandise, or property from any risk, loss, or damage, such agreement or engagement is deemed to be a contract for sea insurance.

A contract for sea insurance (other than such insurance as is referred to in Section 55 of the Merchant Shipping Act Amendment Act, 1862[1]) is not valid unless the same is expressed in a policy of sea insurance.

No policy of sea insurance made for time must be made for any time exceeding twelve months (see p. 77).

A policy of sea insurance is not valid unless it specifies the particular risk or adventure, the names of the subscribers or underwriters, and the sum or sums insured, and is made for a period not exceeding twelve months (and as to continuation, see p. 77).

Where any sea insurance is made for a voyage and also for time, or to extend to or cover any time beyond thirty days after the ship shall have arrived at her destination and been there moored at anchor, the policy is to be charged with duty as a policy for a voyage, and also with duty as a policy for time.

A policy of sea insurance may not be stamped

[1] By Section 55 of the Merchant Shipping Act Amendment Act, 1862, now replaced by Section 506 of the Merchant Shipping Act, 1894, insurances effected against all or any of (1) any loss of life or personal injury to any person being carried in any ship; (2) any damage or loss caused to any goods, merchandise, or other things whatsoever on board any ship; (3) any loss of life or personal injury caused by reason of the improper navigation of any ship to any person carried in any other ship or boat; (4) any loss or damage caused by reason of the improper navigation of any ship to any other ship or boat, or to any goods, merchandise, or other things whatsoever on board any other ship or boat; and occurring without the actual fault or privity of the owners, were not to be invalid by reason of the nature of the risk.

at any time after it is signed or underwritten by any person except—

(*a*) Any policy of mutual insurance may, if required, be stamped with an additional stamp, provided that at the time when the additional stamp is required the policy has not been signed or underwritten to an amount exceeding the sum or sums which the duty impressed thereon extends to cover;

(*b*) Any policy made or executed out of, but being in any manner enforceable within, the United Kingdom, may be stamped at any time within ten days after it has been first received in the United Kingdom on payment of the duty only.

But a policy of sea insurance for the purpose of production in evidence may legally be stamped after execution, under a penalty of £100.

Nothing in the Act prohibits the making of any alteration which may lawfully be made in the terms and conditions of any policy of sea insurance after the policy has been underwritten, but the alteration must be made before notice of the determination of the risk originally insured, and must not prolong the time covered by the insurance beyond the period of six months in the case of a policy made for a less period than six months, or beyond the period of twelve months in the case of a policy made for a greater period than six months, and that the articles insured must remain the property of the same person or persons, and no additional or further sum be insured by reason or means of the alteration.

If any person becomes an insurer upon any sea insurance, or enters into any contract for sea insurance, or directly or indirectly receives or contracts or takes credit in account for any premium or consideration for any sea insurance, or knowingly takes upon himself any risk, or renders himself liable to pay, or pays, any sum of money upon any loss, peril, or contingency relative to any sea insurance, unless the insurance is expressed in a policy of sea insurance duly stamped; or

Makes or effects, or knowingly procures to be made or effected, any sea insurance, or directly or indirectly gives or pays, or renders himself liable to pay, any premium or consideration for any sea insurance, or enters into any contract for sea insurance, unless the contract is expressed in a policy of sea insurance duly stamped; or

Is concerned in any fraudulent contrivance or device, or is guilty of any wilful act, neglect, or omission, with intent to evade the duties payable on policies of sea insurance, he for every such offence incurs a fine of £100.

Every broker, agent, or other person negotiating or transacting any sea insurance contrary to the true intent and meaning of the Stamp Act, or writing any policy of sea insurance upon material not duly stamped, for every such offence incurs a fine of £100, and has no legal claim to any charge for brokerage, commission, or agency, or for any expenses, and any money paid to him in respect of any such charge is deemed to be paid without consideration, and remains the property of his employer.

If any person makes or issues, or causes to be made or issued, any document purporting to be a copy of a policy of sea insurance, and there is not at the time of the making or issue in existence a policy duly stamped whereof the said document is a copy, for such offence, in addition to any other fine or penalty to which he may be liable, he incurs a fine of £100 for Stamp Duties on Policy of Sea Insurance. (See for Duties, Part III, Chapter XXVIII.)

By the Revenue Act, 1903, Section 8, it is provided that a policy of insurance made or purporting to be made upon or to cover any ship or vessel, or the machinery or fittings belonging to the ship or vessel whilst under construction, or repair, or on trial, shall be sufficiently stamped for the purposes of the Stamp Acts if stamped as a policy of sea insurance made for a voyage, and though made for a time exceeding twelve months shall not be deemed to be a policy of sea insurance made for time.

As to policies containing a continuation clause, see above, p. 77.

AUTHORITY.—*Arnould*, "Law of Marine Insurance".

CHAPTER X

THE BOARD OF TRADE'S CONTROL OVER SHIPPING—LEGAL PROCEEDINGS

The Board of Trade—Legal Proceedings

THE BOARD OF TRADE

Introductory

In the course of our treatment of Shipping we have had occasion to see that the general control in the matter of superintendence of British Merchant Shipping and Seamen is vested in the Board of Trade, with powers to make rules and regulations supplementing the Merchant Shipping Acts, and to appoint officers to carry out and secure the observance of these regulations and enactments.

On various occasions, and particularly in recent times, the Board of Trade in its control of British Shipping has been subjected to severe criticism, both at the hands of those who know and those who cannot be presumed to know either the law, the science of shipbuilding, or the powers which actually are vested in the Board. It is in connection with the rules made with regard to the safety of life at sea that this criticism has been chiefly seen, and principally in consequence of the loss of the *Titanic*. Shortly after the official enquiry, presided over by Lord Mersey, new draft rules were issued, which are noticed elsewhere (Chapter V of this Part); but there has been a persistent demand in certain quarters that the control of the Board of Trade and the constitution of its Marine Department and Advisory Committee should be thoroughly overhauled. Indeed, in some quarters it has been claimed that a separate Board of Transport for the especial care and control of British Shipping should be set up; and that the duties of classification now performed by Lloyd's Register, the British Corporation, and other societies, should be taken over by officials of the Board of Trade. It must, however, be seen that something further even than this is required, namely, an International Convention, under which rules may be framed so that the world's shipping may be controlled by a system which is recognized by the wisdom of all nations to be that most conducive to the safety of all who travel by and who are employed in either passenger or cargo vessels. In this both Lord Mersey's Report and the Report (1912) of the Advisory Committee agreed, and the subsequent Draft Rules issued by the Board of Trade were, as the President said, subject to further reconsideration by the light of any conclusions arrived at by international negotiation. In the House of Commons they were severely criticized from all sides and defended by the President.

The general constitution of the Board of Trade and its many departments have been noticed in Part I, Chapter IX. In the present connection it is the Marine Department and the Harbour Department, each under the authority of an Assistant Secretary, which alone concern us, and principally the former. The General Register and Record Office of Shipping and Seamen, Tower Hill, to which returns must be made; the Marine Consultative Branch, at Victoria Street, and the Marine Survey Staff, Mark Lane, London, have also been noticed at the same place.

The Advisory Committee

In exercising its powers of making and revising rules the Board of Trade seeks the advice of a

Merchant Shipping Advisory Committee and other Committees. The Advisory Committee on Life-saving Appliances, it is provided by the Act, is to consist of members holding office for two years. It is composed of three shipowners selected by the Chamber of Shipping of the United Kingdom, one shipowner selected by the Shipowners' Association of Glasgow, and one by Liverpool associations, two shipbuilders appointed by the Institute of Naval Architects, three persons practically acquainted with navigation selected by recognized shipmasters' societies, three persons qualified as able-bodied seamen selected by recognized seamen's societies, and two persons selected conjointly by the Committee of Lloyd's, the Committee of Lloyd's Register, and the Committee of the Institute of London Underwriters. It is said in some quarters that the Committee is too much made up of shipowners, underwriters, builders, and other interested persons, and consequently that the inspection of vessels is inadequate, and insufficiently stringent rules are adopted in the general public interest.

Complaints as to Survey and Equipment

The survey of ships has been shown in some recent cases to have been of a perfunctory character, and while certificates are required for officers and A.B. seamen (see Chapter III of this Part), it is a matter of complaint that there is no testing of seamen before they are engaged, and that ships are often sent to sea with a totally inadequate equipment of competent men.

The welfare of our mercantile marine is a matter of the highest public interest, affecting the very life of the nation, and if these charges are well founded it behoves the responsible department to act promptly in the large interests of the public safety and of those engaged at sea.

Recent Conflict of Opinion

The Advisory Committee's Report (1912, Cd. 6353) itself differed in one important direction from the draft Rules (Cd. 6402) issued just after by the Board of Trade, viz. as to the provision of boats; the Committee, as well as Lord Mersey's Report, regarded lifeboats or life rafts as sufficient, while the Regulations required lifeboats for all on board, including "decked lifeboats" but not collapsible boats. (See also Chapter V of this Part.)

It is worthy of note here that the reservations of Captain G. N. Hampson, one of the members of the Advisory Committee, in the Report of the Committee (1912) contained very serious reflections on the present system of control, as well as recommendations on important matters either not dealt with in that Report or regarded differently by the majority of the Committee. After referring to the danger of fire (which can only be met by more adequate boat provision) he wrote:—

"It is even more imperative that there should be efficient and periodical inspection and supervision by officials of the Board of Trade who have had long practical experience at sea, and thereby possess that knowledge of such matters without which any form of inspection or supervision of the kind would be valueless. At the present time, in most cases, merchant ships proceed to sea without any inspection of the kind whatever, and it has been proved before the Committee that where the life-saving appliances of passenger vessels have been inspected, the inspection has been carried on by officials who have had no practical experience in these matters.

". . . Further, it is obvious that, in all cases, in addition to her various life-saving appliances, the navigational equipment of a ship in the way of charts, compasses, ship's logs, leadline, and the like, should be carefully inspected by a Board of Trade surveyor whose seafaring experience has been such as to give him expert knowledge of these essentials to the safety of a ship and her passengers and crew. At present no such inspections are carried on, and naturally passengers and crews are constantly exposed to the gravest dangers. There is no reason whatever why such inspections cannot be carried out, except on the ground that the nautical staff of the Board of Trade is hopelessly inadequate. This is a serious and dangerous admission, which could most easily and effectually be remedied. It is urged by the Board of Trade that responsibility for safety of life at sea does not rest so much upon them as upon shipowners and shipmasters; but the time has arrived when they should most certainly take over the first responsibility in this direction, and the provision of a proper supply of nautical surveyors would then be a great protection to merchant shipmasters, who, in so many cases, are helpless simply because every item of the expense which they may suggest is brought under the close and, ofttimes, unreasonable criticism of their employers."

Captain Hampson urged that cargo vessels should receive as much attention as passenger vessels.

"Passenger and cargo vessels alike should be subjected to compulsory surveys periodically, not at the hands of classification or other societies, but by Board of Trade officials, who should be given the fullest powers in this way. Surveys carried out by classification societies are in no sense adequate, for usually they mean that life-saving appliances and such like are never surveyed at all. . . . If only one life at sea is lost through a preventable cause, then it is quite sufficient to justify legislation, which would most certainly ensue if similar loss of life arose ashore."

Hostility of Shipowners

On the other hand the new draft regulations of the Board of Trade requiring foreign-going ships to provide sufficient lifeboat accommodation for all on board evoked the warm hostility of the shipowners. The Shipowners' Parliamentary Committee, claiming to represent nine-tenths of the total British tonnage, passed resolutions to the following effect:—

1. That it would be disastrous to the future development of the Mercantile Marine to attempt any reorganization of the Marine Department of the Board of Trade with a view of substituting departmental responsibility for that of the shipowners in regard to the design, building, and equipment of vessels.

2. That any departure from the principle adopted unanimously by the Merchant Shipping Advisory Committee, upon which all the shipping interests were fully represented—namely, that "The stability and seaworthy qualities of the vessel itself must be regarded as of primary importance, and every provision made against possible disaster must be subordinated to that primary consideration"—will gravely imperil the safety of life at sea.

3. That the Draft Life Saving Appliances Rules presented by the President of the Board (see Chapter V of this Part) are a departure of a most serious character from that principle, inasmuch as they would, if adopted, impose on passenger ships a hard-and-fast lifeboat scale based solely on the numbers carried, irrespective of all other considerations.

4. That having regard to the very great advance made during the last thirty years towards securing the safety of life at sea, and to the fact that such advance has resulted directly from steps taken voluntarily by the shipping interests, the unanimous recommendations of the representatives of all the shipping interests, as embodied in the report of the Merchant Shipping Advisory Committee, under which boat and other efficient buoyant apparatus sufficient to accommodate all on board on foreign-going passenger ships would be carried with safety to the ship, should form the basis of the new Life Saving Appliances Rules.

Objection, it will be noticed, was also taken to the proposal that the Board of Trade's Marine Department should be reconstructed and replace by its own officials the organizations now responsible for survey and classification. Mr. T. Royden, President of the Chamber of Shipping, said:—

"To attain the maximum of safety shipowners and shipbuilders have worked for years and are still working in the closest alliance with the underwriters—an interest that has no concern in our profits, but the greatest concern in the safety of our ships and of the cargoes we carry. In that alliance we have assisted in developing organizations such as Lloyd's Register, and of recent years the British Corporation for the Survey of Shipping, by which not only is the keenest watch kept on the safety of our ships, but means are also provided for obtaining the highest expert advice upon all proposals or suggestions for the improvement of their hulls, machinery, or equipment. These organizations are in constant touch, not only with the shipowners and their expert advisers, but also with the shipbuilders and the engineers, and they are able to deal with the rapid developments in shipbuilding science in a manner in which no Government Department, hampered as it must be with regulations, could ever hope to deal. They are at work, day in and day out, dealing with the problem of applying to the best advantage the constantly varying means which the naval architect, the shipbuilder, and the engineer devise for increasing safety. They do not, as Parliament, which has never time to give to the thorough investigation of such problems, only face them at long intervals and in the light of some exceptional disaster."

For these reasons he thought that it would be a disaster for Parliament to attempt the reorganization of the Marine Department of the Board of Trade, with the object of substituting the principle of departmental responsibility for the general design, building, and equipment of our vessels, for the principle of the individual responsibility of the shipowner, under which our mercantile marine had grown as that of no other nation had grown, and under which safety of life and property at sea had increased in such a marked degree.

With the general control of the Board of Trade, Mr. Royden agreed. The Board should have the fullest power to investigate into the nature and causes of any accident or damage which a ship had sustained or caused. Such powers were necessary to detect not only the rogue who was intentionally risking the lives or property of others, but also the reckless and careless. The Board should have a general power of supervision, through its surveyors and officers at every port, over the conditions in which vessels are sent to sea. This general power of supervision was a police power, and to make it effective it was only necessary to have a sufficient number of surveyors fully qualified to detect and prevent the sending to sea of vessels which by reason of defects in the hull, machinery, or equipment, or by reason of undermanning, or by reason of improper loading, were in an unseaworthy state. Then the Board should have power to protect the seaman against imposition, and to obtain for him the conditions which were necessary for his comfort and well-being on the voyage.

The Opinion of Professor Biles

Professor J. H. Biles, one of the assessors at the *Titanic* Enquiry, and Chairman of the Life Saving Appliances Committee appointed by the Board of Trade, discussed these questions at Glasgow University in October, 1912. He said:—

"Safety at sea depends primarily on safe navigation; secondly, on making the ship as safe as possible against the accidents of the sea; and, thirdly, in the provision

of means of saving life in the event of the failure of the ship to remain a safe place for those on board."

Safe navigation, he said, depended on the skill and judgment of the officers and on the faithful performance of duty by the crew. With the second and third conditions he (as a naval architect) was directly connected. The ship must be strong and stable and so constructed that she should have a margin of safety sufficient to prevent her from having to be abandoned in any conceivable case. If we could be sure that we could do this there would be no necessity to rely upon the third provision for safety of life. But it was not possible for fallible human nature to be sure that we might be completely informed as to all possible cases. "Knowledge grows but wisdom lingers." "With the knowledge we have we are not always wise enough to fully profit by it. The shipping community is trying to profit by the knowledge acquired by the *Titanic* catastrophe. Let us hope that it will be wise enough to profit fully by it."

As to the powers of the Board of Trade, Professor Biles was in favour of extension, holding it to be absolutely necessary that the Board should by its own officials have power over the construction of ships:—

"The Board of Trade is in this position with reference to the safety of the ship herself that, as far as subdivision is concerned, it has practically no controlling power upon the shipowner. It can, it is true, compel the shipowner to give four water-tight bulkheads—a number totally useless for safety if any compartment between these bulkheads is open to the sea—but this is all. The amount of safety which has been given to ships as regards subdivision has been wholly determined by the shipowner. It is not, therefore, surprising that Lord Mersey's Court should have recommended that power should be given to the Board of Trade to review the designs of ships in their early stages and to direct such amendments in them as may be necessary and practicable for the safety of life at sea in ships. Shipowners do not like this suggestion. They wish to be let alone. No doubt many are willing to make their ships as safe as they can be made. The shipowners, speaking collectively, say that the safety of the ship is of primary importance. But who is to see on behalf of the passengers that the maximum practicable amount of safety is given to the ships? What is to prevent some niggardly shipowner from putting in less than the maximum practicable amount? Certainly not some equally niggardly shipbuilder, who will occasionally in times of severe competition cut down the amount of subdivision to reduce his price, and thereby secure an order in competition with the other shipbuilders who are more regardful of the safety of the travelling public. Nobody but a Government can effectively fix a standard of safety, and none but a trained naval architect can determine whether a proposed arrangement of subdivision does or does not reach that standard. Hence it is absolutely necessary for the protection of the travelling public, whether shipowners like it or not, that the Board of Trade should have some power to examine the designs of the subdivision of ships before it is too late to modify details in their construction so as to satisfy themselves that the proper standard of safety is obtained. To do this the Board of Trade must have the assistance of trained naval architects."

The General Control of the Board

The general control of the Board of Trade over merchant shipping is provided for by Part XIV of the Act of 1894, supplemented by certain provisions in later Acts. The Board has full control in all matters except revenue. All consular officers, officers of Customs abroad, all local marine boards and superintendents, are required to make returns and reports on any matter relating to British shipping and seamen as the Board may direct, and they must produce official logbooks or other documents as required.

Besides the standing Advisory Committee, to which reference has been made, the Board appoints from time to time special Committees to enquire into and report upon the various matters that call for investigation or revise regulations, e.g. the Bulkheads Committee and Davits and Boats Committee.

The Board may take, and frequently does take, proceedings in the names of any of its officers to secure the observance of the law. The Board is legally represented on many other occasions.

Compliance with the Act may also be enforced by any officer of the Board of Trade, commissioned officer of His Majesty's ships in full pay, British consular officer, Registrar-General of Shipping and Seamen or his assistant, any chief officer of Customs in His Majesty's dominions, or any superintendent.

Fees and fines are paid into the Exchequer and go to the Consolidated Fund.

The Board must supply all forms which are prescribed at reasonable prices, and it is an offence to forge or fraudulently alter any such form.

Surveys

A passenger or emigrant ship, as we have seen in Chapter IV of this Part, must pass the initial survey of the shipwright and engineer surveyors of the Board. A cargo ship is not subjected to compulsory survey, although most cargo ships pass the survey of the classification societies.

The Board of Trade appoints, and may remove, surveyors of ships and a Surveyor-General in the United Kingdom to make returns to the Board of Trade. Surveyors who accept money otherwise than as allowed by the Board may be fined. The Board may also appoint inspectors to enquire into accidents causing damage to ships and into the

non-compliance with the law as to sufficiency and condition of the hull and machinery of any steamship. Such surveyors and inspectors are authorized to go on board any ship, and inspectors may enter premises, summon any person to attend, or require the production of books and documents. The Board may, in its discretion, register private signalling codes.

All ships, cargo as well as passenger, are liable to be detained by the officers of the Board of Trade on account of defective condition of hull, equipment, or machinery, improper loading, or undermanning.

The Board's Special Authority

As we have already seen in preceding chapters, the Board of Trade is the authority for securing observance of the right use of the British flag; granting certificates to seamen and engineers; prescribing forms for the engagement of seamen; constituting a special insurance society for seamen under the National Insurance Act, 1911; in certain cases disposing of the effects of dead seamen; prescribing the form of the official log to be kept by masters; constituting pilotage and lighthouse authorities; receiving returns on various matters relating to shipping; the settlement of salvage disputes when referred to by the parties; the appointment of arbitrators in disputes as to wreck, and of surveyors of wreck; receiving returns from and supervising work at lighthouses; and in connection with very many other matters.

Regulations by the Board of Trade, which are issued under Orders in Council, are made with regard to collisions, safety of boats and life-saving appliances, the marking of load lines, casualties, and other matters such as the carriage of wood as deck cargo; all these have been commented upon elsewhere in this Part.

LEGAL PROCEEDINGS

In England the Courts in which actions relating to shipping are brought are the High Court, Admiralty Division, and King's Bench Division (generally in what is known as the "Commercial Court"). Cases involving smaller amounts are tried in the County Court. Certain local Courts have also jurisdiction. A description of the Courts of Justice and general legal procedure has been given elsewhere (Part III, Chapter XXVI). In certain cases leave may be obtained to serve process on a defendant who is out of the jurisdiction.

The Admiralty Court

The Admiralty Court—now the Probate, Divorce, and Admiralty Division of the High Court—derived its jurisdiction from the Lord High Admiral, exercising the authority of the Crown, and acting through a deputy as judge. The law is made up of the law and custom of the sea, incorporating regulations from certain old codes, and in modern years supplemented and amended directly by statute.

In particular the Admiralty Court was given jurisdiction over—

Claims for building, equipping, or repairing any ship, if at the time of commencing the action the ship, or the proceeds thereof, are under arrest of the Court;

Claims for necessaries supplied to any ship elsewhere than in the port to which the ship belongs, and claims for damage to cargo imported, unless the owner is domiciled in England or Wales; and

Claims for damage done by any ship.

The Court also decides questions between co-owners as to ownership or the disposal of the ship or division of earnings. (See Chapter II of this Part.)

Unusual claims for masters' or seamen's wages, mortgage claims, and actions relating to towage, salvage, and collision are tried in this Court.

In Admiralty the remedy is either against the owners personally or by claim upon the ship itself —*in rem*, as it is called.

The Maritime Conventions Act, 1911, was passed to give effect to the Brussels Convention, 1910, and is in operation throughout His Majesty's dominions, except Canada, Australia, New Zealand, the Union of South Africa, and Newfoundland. Under this Act the jurisdiction of any Court dealing with damages for loss or injuries to ship, cargo, or property is extended to cover damages for loss of life or personal injuries.

Actions in respect of damages or loss due to the fault of another vessel, to a vessel, or cargo, freight, or property, or for loss of life or personal injuries, or for salvage services, must be brought within two years from the date when the damage was caused, or the salvage services were rendered. Actions for contribution to damages recovered against one vessel for the joint fault of that and others must be brought within one year from payment; but the Court having jurisdiction may for good cause extend the time.

Collision

Where damage has been sustained through collision owing to the negligence of those in charge of a vessel an action may be brought on the ordinary grounds. (See Part III, Chapter XXII.) Damage may be shown to be due to inevitable accident; but the effect of contributory negligence is different under the Admiralty law to what it is under the ordinary law. Where both vessels are to blame, the joint damage is apportioned between the two, which may mean a very different thing from each bearing its own loss. Where a barge in tow of a tug came into collision with a steamship, owing to the fault of the steamship and the tug, the owners of the barge, which was not to blame, were held entitled to recover the whole of their loss from either of the wrongdoers. The barge was completely under the control of the tug, but was held not to be so "identified" with it as to be precluded from recovering (*The Devonshire*, etc., 1912).

Under the Maritime Conventions Act, 1911, where damage or loss is caused by the fault of two or more vessels to one or more of those vessels, or to their cargo or freight, or any property on board, liability is in proportion to the degree in which each vessel is in fault; but if there are no circumstances showing degrees of fault, the damages are apportioned equally; and a vessel is not to be held liable for loss to which her fault has not contributed, nor is any liability nor any exemption under any contract or general law affected by the statute.

Where loss or personal injuries are suffered by any person on board a vessel due to the fault of that or any other vessel, or vessels, the liability of the various owners is joint and several.

Where damages are recovered against one vessel more than in proportion to her fault, there is a right of contribution against other vessels in fault.

It has been seen elsewhere (see Chapter V of this Part) that where injury takes place without the actual fault or privity of the shipowner, he is entitled to limit his liability. (See Chapter VI of this Part.)

It is in the Admiralty Court that proceedings are taken to obtain a declaration of forfeiture of a British ship or the removal of a master when a breach of a regulation entailing such a penalty has occurred. (See Chapter III of this Part.)

In claims against the ship it is the last claim that ranks first, as it is considered that the last advance or service has benefited all the other parties interested. The claim for seamen's wages, however, has priority over one on a bottomry bond.

It has been seen elsewhere that claims for seamen's wages must generally be brought in a Court of Summary Jurisdiction (see Chapter III of this Part), which Courts are also entitled to hear disputes as to passengers' contracts. (See Chapter IV of this Part.)

County Court Jurisdiction

Certain County Courts specially authorized have Admiralty jurisdiction in cases within their districts generally when the claim is not over £300, or in cases of greater amount by consent. Claims for towage or necessaries supplied to a ship can be brought in the County Court if not over £150. Salvage and similar cases can be heard there in any case by consent, where the value of the property saved does not exceed £1000, or where the amount claimed does not exceed £300. The judge sits with an assessor.

Certain proceedings under the Merchant Shipping Acts may be brought in any County Court, or alternatively the Police Court.

The Cinque Ports

The Court of Admiralty of the Cinque Ports has jurisdiction there, coextensive with that of the High Court. The Commissioners in each of the Cinque Ports determine claims to salvage or for similar services. Two or more are appointed in each port by the Lord Warden. There may then be an appeal either to the Cinque Ports Admiralty Court or to the High Court. There is also an alternative right of appeal from local County Courts to the Cinque Ports Admiralty Court.

Other Jurisdictions

In Scotland Admiralty actions are heard in the Court of Session and in the Sheriff Courts. The High Court of Justice in Ireland (as an Admiralty Court), the Royal Courts of Jersey and Guernsey, and the Admiralty Court of the Isle of Man have local jurisdiction.

There are Colonial Courts of Admiralty, with appeals to the local Appeal Court and finally to the Privy Council.

Proceedings under the Merchant Shipping Acts

The prosecution of offences under the Merchant Shipping Acts is specially provided for by the Act of 1894. Offences may be treated as misdemeanours or tried summarily before Justices (the usual course). Jurisdiction is given either where the

offence arose or where the offender is found. Ships lying off the coasts are presumed to be within the jurisdiction of the Justices on the adjoining land.

Offences on board ship by British subjects on the high seas or in a foreign port, or on a foreign ship to which they do not belong, or by persons not British subjects on a British ship, may be prosecuted whenever the offender is found within the jurisdiction of any Court in His Majesty's dominions.

Offences committed by British seamen at foreign ports are within the British Admiralty jurisdiction.

A foreign ship which in any part of the world has caused injury to any British property may, whenever found within British territory, be arrested.

If injury is caused in any port of the United Kingdom or within the three-mile limit by the wrongful act or negligence of any owner, master, or crew of any ship, or through the defective condition of the ship or its equipment, a Court may direct the detention of the ship until satisfaction is rendered or security is given.

British masters, seamen, or apprentices committing offences abroad may be taken to the United Kingdom or to a British possession for trial.

In Scotland offences are prosecuted in the High Court, and if not amounting to felony summarily before the Sheriff or the Justices.

Seamen in British Vessels

It may be of interest to notice here that, from the quinquennial census taken on 3 April, 1911 (Cd. 6442), 208,214 seamen appear to have been then employed in trading vessels and 25,054 in fishing vessels, registered in the British Isles. During a period of twenty years the number of British seamen increased by over 9000, Lascars by 21,583, and foreign seamen by 4845.

In more recent years the number of British seamen has been rising, there being 4210 more in 1911 than in 1906. In trading vessels, however, the increase has been in the engineers' and stewards' departments, as in five years the increase in sailors was 279 only, with a reduction in the foreign seamen employed.

The general decrease in the demand for "sailors" is due to the reduction in sailing vessels from 2021 in 1891 to 247 in 1911.

There is a slight increase in the supply of young British sailors and apprentices in steam vessels.

PART VII

ACCOUNTANCY

INTRODUCTION

The matters which have been left to be dealt with in the concluding Part of this work are really those most essential to business success. No doubt in the old days many people "muddled through", keeping the records of their fewer and less complicated transactions in their heads or by some very rough and original methods. Many may still achieve a middling success in some businesses without the use of any system of bookkeeping that would pass muster with any accountant, or be accepted as a satisfactory record of the transactions of their businesses by any outsider. For the rest, the absence of systematic attention to accounts, or the failure to use a system suitable for the particular business carried on, is courting disaster. Such an omission is an inducement to carelessness in principals and servants, often leads to an entirely false impression in the mind of the proprietor as to the true value and trend of his business, and not infrequently supplies a loophole for fraud. An account is a record and a check, a record which everyone needs to show him the path by which he has come and to guide him in the path which he should pursue, a check both on his business and his private expenditure, and on those who work under him, for whom of necessity while he provides opportunities for service he must afford means for the dishonest use of those opportunities. An adequate system of account is to be regarded, therefore, not alone from the point of view of one person's or firm's advantage, but also as a duty to other proprietors, to employees, and to the public generally.

But it is possible that the very reliance upon a system of account may prove the ruin of a business, may lead to a false security, if the record is imperfect and the system not a suitable one for the case; or an over-elaboration in the accounts may not only cause a great waste of the time both of principal and staff, but fail to provide an easily intelligible summary of the true state of affairs. A system which is so complicated that only a professional accountant can understand it will deprive the proprietor of a due sense of the responsibility which rests upon him and no one else. The fashion of some business people is to rely too much upon accountants' statements, to await the result of a formal investigation, especially when it is known that it cannot reveal anything satisfactory, where they know, or should know, more or less what the position is from their own observation and dealings.

Then, again, in any business into which the holding of stock enters, the true valuation of that stock is all-essential to a correct ascertainment of the position of the business, and that is a figure which it is not for the accountant to supply. Many cases

in which a balance sheet has been impugned have turned upon stock valuation. Where the principals have defaulted and it is useless to sue them, it has been sought sometimes to cast liability upon the auditor for negligence, a course which has not been successful unless there have been suspicious circumstances which the auditor ought to have noticed. The primary responsibility for a man's business and statements in regard to it must rest upon him, and it is ridiculous for a man, or the directors of a company, to attempt to cast upon an accountant the responsibility for values or for the continuance of a business of which the career is obviously hopeless.

The object of the chapters which follow is not only to urge the importance of the keeping of accounts—that is hardly necessary—but the keeping of accounts upon approved methods and under conditions which will satisfy the personal demands of the proprietor and also the just claims of the business community. It is pointed out that although our law, unlike the law of some European countries, does not make the keeping of business records compulsory, yet that under certain statutes the person who has neglected this precaution is penalized, or is placed at a disadvantage, especially when he gets into difficulties. The requirements of the Companies Acts which, at an early stage in the inception of modern joint-stock companies, provided that accounts should be kept for the information of shareholders and the public, have been greatly strengthened with the growth of this form of trading. Familiarity with such methods of accounting by companies, through the participation in their proceedings in some way or other of most business men, has caused the voluntary adoption of similar forms of account in private businesses. Professional reports and investigations have become common, and the production of certified balance sheets for a lengthy period has been demanded by the prudent as a preliminary to any negotiation.

This change in business requirements, together with the legal necessity for the appointment of an auditor to every limited company, and the circulation and the filing at Somerset House in the case of public companies of accounts which often only a professional accountant could prepare, has been responsible for the rapid rise and advance to a leading place amongst the professions of the accountant and auditor. Those with the definite professional training and diploma have gradually displaced the casual and amateur auditors, who once acted in the more or less efficient discharge of duties to such companies, societies, institutions, and authorities, where some sort of audit was considered necessary. But this is not yet entirely so, for while the profession has secured charters and recognized status, and control over and power to protect its own members, it has not yet been able to prohibit the practising of those not so certified, as in the case of law and medicine. This professional standpoint has been considered in Part I. The profession has established itself in the public estimation, and those who have occasion to employ accountants are not slow to demand the full qualification. The accountant is charged with duties of the highest responsibility, often of a quasi-judicial character, being appointed by the Court as receiver under partnership, company, or bankruptcy petitions, as well as by debenture holders, shareholders, and others on voluntary resolution.

While the duties of auditors are so responsible, auditors are not to be held liable for the faults of others, the negligence or fraud of principals, directors, or agents, the discovery of which wrongdoing has not clearly been within the auditor's duties. Sir William Plender, one of the distinguished leaders of the profession upon whom an honour has been conferred, was quick to disclaim this responsibility. In his Presidential Address to the Institute of Chartered Accountants he said: "Auditors are in no way concerned with the policy of a company. That is the directors' responsibility solely. Nor is the auditor concerned in the volume of business a company does, whether it is over-trading, whether its working capital is insufficient, whether it is carrying on operations on too extensive a scale in countries where credit is bad and economic conditions are unfavourable." Sir William Plender might have added the words of Lord Justice Lopes in the well-known case of *In re Kingston Cotton Mills* (1896), "An auditor is not bound to be a detective, or . . . to approach his work with suspicion, or with a foregone conclusion that there is something wrong. He is a watchdog but not a bloodhound."

The precise duty of an auditor must, however, depend upon the circumstances of the case, and it is safe to say that much more is expected of him than used to be the case, and still more will be expected in the future.

In the first chapter of this Part Accountancy has been treated in its general principles and practice, a chapter which will be found to contain matters of interest and profit to everyone engaged in any form of business. In subsequent chapters points of detail have been more fully treated and special subjects attacked. Many of these subjects cannot be fully understood without some knowledge of the law and the practice of the Courts—proof of the technical as well as all-round equipment of the accountant. So far as this book is concerned the legal treatment in general has been provided in Part III. Some of the principles expounded in this Part require a brief statement of the law, which has been given, but the general legal matter may be consulted by reference elsewhere. Methods of Balancing Accounts are discussed in Chapter II. The important distinction between Capital and Revenue, a subject which intrudes itself elsewhere, falls to Chapter III. The preparation of Balance Sheets, their detailed accuracy and correct understanding by those interested, forms the subject of Chapter IV. The Accounts of Limited Companies, which both from their nature and the repuirements of law must be kept on an extent and in a manner specially provided, have received separate treatment. Similarly, special conditions obtain in regard to accounts required in cases of Insolvency and Bankruptcy, and separate treatment is therefore accorded to them.

Reserve and Reserve Funds, the Double Account System, the Falsification of Accounts, Investigations and Reports for various purposes, are subjects dealt with in other chapters. The requirements of the law and the custom of Inland Revenue officials in regard to Income Tax have been stated in an earlier Part, but they make a special form of account highly desirable, and from this point of view the principles have been discussed here and specimen forms and returns given.

Consideration of the special accounts required in connection with Partnerships, Executorships, and Receiverships, might have occupied much more space than the chapter which can here be allowed, and another chapter which might be almost indefinitely extended is that devoted to Accounts Applicable to Various Businesses. Here Branch, Departmental, and Agency Accounts, Tabular Accounts, Cost Accounts, Hire Purchase Accounts, Stocks and Stores Accounts, call for as full consideration as the limits of space can afford.

The subject of Municipal Finance, with its forms of account and system of audit, is of great public concern, affecting the pocket of every ratepayer. But it is one of technical difficulty, and it is doubtful if the ratepayer, any more than the shareholder in the case of companies' accounts, is really set to understand it. It is hoped that the outline here given by an expert whose public duties give him the charge of the accounts of one of our leading cities will be found useful from all points of view.

The concluding chapter deals with the General Principles of Audit in commercial businesses, and the Duties and Responsibilities of Auditors.

CHAPTER I

PRINCIPLES AND PRACTICE OF ACCOUNTANCY

Introductory—Primary Books—Double Entry—Trial Balance—Subsidiary Books—Classification and Organization of Accounts—Account-keeping without Books—The Law as to Keeping Accounts.

INTRODUCTORY

It should not be necessary in the twentieth century to urge upon business men the folly of not keeping a systematic record of commercial transactions. It is apparent, however, from the report frequently made in cases of bankruptcy that insolvency has been brought about largely by the debtor's failure to keep proper books of account, that the necessity is not fully realized. The science of bookkeeping has now been advanced to a stage at which a thoroughly satisfactory record may be kept, with a minimum of labour, of the transactions of any undertaking, from the smallest of shops to the largest of the many huge stores and financial concerns of various kinds. An efficient system of accounts is required, not only for the protection of the trader himself, but of those with whom he has dealings; for a merchant without such a system is in a similar position to the master of a vessel entering a foreign port without a pilot—he is a danger not merely to himself but to others.

The keeping of accounts has reached its present degree of excellence by a gradual process of development. No ready-made system was published for the guidance of the commercial world; the earliest treatises on the subject being explanations of the practice of merchants who had devised and elaborated methods they had found to be suitable for their requirements.

From the day when the first credit dealing took place between man and man a record became necessary. This may have been kept by the notched stick or some other primitive means, but record there must have been. The need for a more or less scientific system probably arose from the necessity of keeping an account of the collection of the State revenues; but as early as two thousand years before the Christian era the Babylonian laws provided for the taking of accounts between principal and agent. The researches of antiquarians have established the fact that accounts were kept by the Egyptians, Phœnicians, Persians, and Israelites. It is known that the Greeks and Romans had well-developed systems; and the bankers of the latter nation kept separate accounts for each customer, with one page for debits and another for credits.

In Great Britain the earliest accounts of which a record has been preserved are those of the State, which are more in the nature of a narrative than an account. The earliest English record is dated 1130, that of Scotland 1326.

The difficulties of keeping accounts in the early and middle ages were greatly increased, particularly on the Continent, by the practice of each petty State having a mint and coinage of its own. Another stumbling-block was the use of Roman numerals. Arabic characters were first introduced into Italy in the twelfth century, but their adoption was very gradual, and it was not until the seventeenth century that they came into general use.

Mention has already been made of the fact that bookkeeping was a gradual growth. The greatest steps in advance until comparatively recent times were made in Italy in the Middle Ages, when Venice was the greatest commercial city in the world. The method of account-keeping employed by Venetian merchants became famous all over Europe, and was known as the method of Venice or the Italian method. It will be recalled that

Dominie Sampson in *Guy Mannering* refers to it under the latter name.

The recognition by Italian merchants of the essential fact that every transaction is an exchange of value made the adoption of the double-entry principle inevitable. It was in use in Genoa and Venice in the fourteenth and fifteenth centuries, and has ever since been the basis of all systems worthy of the name. At or about the same time the practice arose of recording accounts in a manner that enabled the position of a business to be viewed as a whole. Previously, while the usage of merchants had been to keep separate accounts for each of their customers, there was no connection between them, and, with the exception of a cash record, no real or nominal accounts were kept. It was, therefore, impossible to prepare a balance sheet from the books. But, early in the fifteenth century, Venetian merchants had so developed their methods that they were able to produce complete profit and loss accounts and balance sheets.

The first printed work published on the subject of bookkeeping was by an Italian monk named Lucas Pacioli in 1494. An English translation of his work, published in 1543, is the earliest known work of instruction in our own language. For nearly a century after Pacioli's book was published no very great advance in the art is to be noticed, but in 1605 a Dutchman named Stevin suggested the grouping of items of a similar nature, with the object of saving labour in recording the transactions in the books. Most modern developments have had the same object in view, and many of the devices now adopted are merely extensions of the principle advocated three centuries ago by Stevin. The history of the development of accounting has been carefully and exhaustively treated by Mr. J. R. Fogo, C.A., in the well-known work edited by Mr. Richard Brown, C.A., from which further information on the subject can be obtained by those interested.

The early methods of European bookkeepers called for the use of three books—the memorial, which was a chronological record of transactions corresponding with what some modern textbooks call the waste book; the journal, in which the transaction was prepared for entry in the third and only really essential book, the ledger. It says much for the insight of the old accountants and bookkeepers that their methods have survived the test of centuries as they have, for, except that various devices, as mentioned above, have from time to time been adopted for saving labour, the journal and ledger remain the two books in use to-day. The former has undergone what may be described as a transformation, but in principle it exists for all entries as it did more than five centuries ago.

Modern Developments and Practice

The great change made in relation to the journal in modern practice is to exclude from it those transactions which, because of their frequency, may conveniently be grouped together, and entered or posted periodically in the ledger in bulk. This applies principally to the purchase and sale of goods, and the receipt and payment of cash. Transactions of these kinds form the great majority of the entries in a merchant's books, and the time saved in entering purchases and sales in separate books in the first instance, and then posting them in total to their appropriate accounts in the ledger, is enormous. And the larger the business the greater is the amount of time and labour saved. Cash receipts and payments which were formerly recorded in the journal are now entered in a distinct book, which is really a ledger account in a separate binding, so kept because of the great number of items. In addition to the transactions mentioned, those relating to the return of goods, and the giving and receiving of bills of exchange, are entered in special books. The development of the science of bookkeeping has, in fact, led to the journal being used for little else than what are known as opening and closing entries, and transfers from one book or account to another—matters which are explained later in this chapter. Most businesses lend themselves to the advantageous division and subdivision of the journal, the principle observed being always the grouping of similar transactions.

Second only in importance to the labour-saving devices in relation to the journal are the improvements which have been made in regard to the ledger and the subsidiary books, with the object of increasing their usefulness as classified records. The form of an account in the ledger is very little different from that of the early accountants, but the wording of entries is much shorter by reason of the facility with which full details of a particular transaction may be ascertained by reference to the book of original entry. But although the form of an account is much the same, the practice of grouping transactions of a similar nature has been extended to ledger accounts. The great majority of those accounts are with persons—personal accounts as they are termed. These are now all kept in the same portion of the ledger; but owing to the vast increase in the size of modern businesses the number of personal accounts has grown too large for one book, and separate

volumes are now used for debtors and creditors. Even this is frequently not sufficient, and the ledgers in very large concerns are further divided into sections of the alphabet. The subsidiary books, particularly the Purchases and Sales Books, are also made to show the transactions of an undertaking in a classified form according to its various departments or contracts. Specimens of such books kept on the tabular system are shown later in this chapter.

PRIMARY BOOKS

The only book which may strictly be described as a primary book is the ledger, which contains the complete and classified record of the transactions of an undertaking. In some countries the use of the journal for recording all the dealings of a business is made compulsory by law, and in those countries the journal, also, may be regarded as a primary book; but no similar provision is in force in Britain. The books which, in the modern development of bookkeeping, have largely taken the place of the journal, but which are really divisions of it, are the Purchases, Sales, Returns, and Bills Books. Other books, such as Stock and Stores Books, are of great convenience in many concerns, and are really further divisions of the journal. The other books, viz. the Cash and Petty Cash Books, which are sometimes regarded as subsidiary to the ledger, and the sections into which the ledger is divided in large concerns, are not subsidiary books, but are volumes of one great book which cannot be contained in one binding because of its size.

Ledger Accounts

The classified record contained in the ledger is kept by means of a series of statements in similar form which are called accounts, a separate one being provided for each individual or thing with whom or with which the trader deals. The common form of ledger account in universal use is as under, the headings being inserted here to make the uses of the different columns quite clear:—

Dr. *Cr.*

Date.	Short Particulars of Transactions.	Fol.	Amount. £	s.	d.	Date.	Short Particulars of Transactions.	Fol.	Amount. £	s.	d.

It will be seen that the account is divided into two parts, each of which is subdivided into four sections, the headings being the same on both sides. The abbreviations Dr. and Cr. at the extreme left and right of the account respectively stand for debtor and creditor, and serve to bring forcibly to mind the fact that, every transaction being a transfer of value, there must be a receiver and a giver in every dealing which takes place—in other words a debtor and a creditor. The recognition and observance of this fact are of the utmost importance for two reasons — firstly, because a complete record cannot be kept without showing the full effect of each transaction; and secondly, because the observance of this truth enables a trader to prove the accuracy of his books, while failure to observe it tends to the commission of errors, and makes their discovery exceedingly difficult.

In making entries in the ledger the bookkeeper must regard each dealing as an isolated transaction, and not as having relation to anything that has happened previously. It is only by adhering strictly to this rule that the final position on an account can be arrived at correctly. When a trader receives cash from a customer, the trader is the debtor and the customer the creditor on that particular transaction, although the customer may on the whole of the previous dealings between them be a large debtor. The fact that he is already a debtor has been recorded when the earlier transactions took place, and he must, therefore, now be regarded as a creditor for what he sends. It follows, then, that the receiver or receiving account on any given transaction is a debtor, while the giver or sender is a creditor.

Groups of Accounts

There are two main groups of ledger accounts—personal and impersonal, the latter being divided into real and nominal accounts. Personal accounts are those in which are recorded the dealings of a business with individuals. Real accounts relate to dealings with property of all kinds; and nominal accounts are those which show the gains, losses, and expenses of a business. Each account is described by a name indicative of the nature of the transactions there recorded. For example, an

account in the name of John Smith contains a record of the dealings with him by the trader in whose ledger the account appears. The method of entering the various items is as mentioned above, viz., to treat him as a debtor for everything he receives, and as a creditor for what he sends. Thus, supposing him to be a purchaser of goods, his account would appear in the following form:—

Dr. JOHN SMITH *Cr.*

1911.				£	s.	d.	1911.				£	s.	d.
Jany.	16	To Goods	18	81	10	2	Feby.	6	By Cash	51	79	9	5
Feby.	21	" "	31	35	8	6	"	"	" Discount	"	2	0	9
"	27	" "	39	18	9	5	March	3	" Cash on a/c	82	45	0	0
March	18	" "	56	26	18	1	"	31	" Balance	c/d	35	16	0
				162	6	2					162	6	2
April	1	To Balance	b/d	35	16	0							

This method of entering what a person receives on one side, and what he sends or is allowed on the other, enables a trader to ascertain at any time the precise position of the account; for, by adding up both sides and deducting the smaller total from the greater, he sees at a glance whether the person is a debtor or a creditor, and for how much. The difference between the two sides is termed the "balance".

Real or Property Accounts

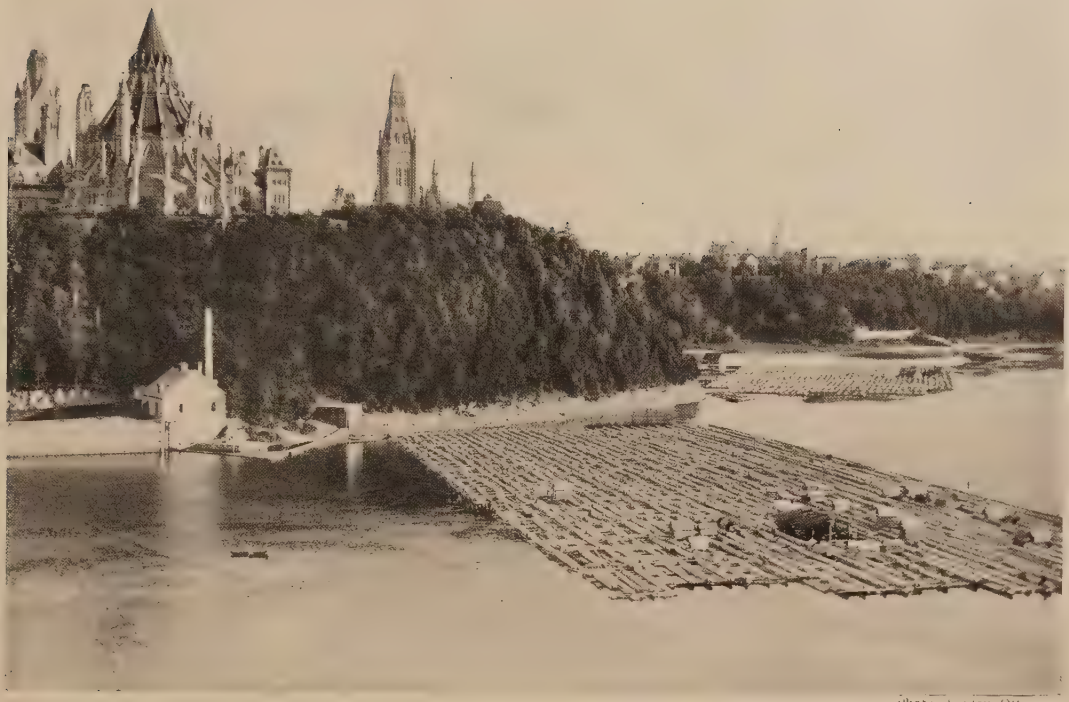
Real accounts are kept on the same principle, the debtor side being used for the cost of the particular class of property recorded in the account, and for any additions or increases in value; while the creditor side records those portions of the property sent away, and any decreases in value. Thus in the cash account the receipts are entered on the debtor side, and the payments on the creditor side, the difference being necessarily the amount of the cash in hand. Similarly on the goods account the purchases are debited, i.e. entered on the debtor side, and sales are credited. But the difference between the two sides is not necessarily, or even probably, the value of the goods remaining on hand, for the reason that the goods received and debited to the account have been entered at one price, and those sold and credited to the account at another price. The balance of a real or personal account must always represent, at any periodical balancing of the books, the amount owing to or by the business on that account. The goods account, therefore, must show the value of the goods on hand after allowing for those which have been sold. This is ascertained by what is called "taking stock", i.e., making a list of all goods in the warehouse, shop, or factory, as the case may be, and valuing them at their cost price. The amount thus arrived at is entered on the credit side of the account as "stock on hand", and forms the first item with which to commence the account in the next trading period.

Balancing the Goods Account

It is obvious that if goods are entered on the debtor side of the Goods Account at cost price and on the credit side at a higher price when sold, the latter side, when the stock on hand is added, must always exceed the debtor side. This is as it should be, for it is on the sale of his goods that a merchant makes his profits, and the difference thus shown on the goods account represents the gross profit he has made on selling. The appearance of the goods account, therefore, at the end of a period of trading would be as follows:—

Dr. GOODS ACCOUNT *Cr.*

1911.				£	s.	d.	1911.				£	s.	d.
Jan.	31	To Purchases during month	25	2356	8	0	Jan.	31	By Sales during the month	25	2276	8	11
Feb.	28	" " "	49	2416	13	4	Feb.	28	" " "	40	3201	4	2
Mar.	31	" " "	55	2585	4	6	Mar.	31	" " "	72	2314	8	2
				7358	5	10					7792	1	3
		" Gross Profit	50	1861	2	6			" Stock on hand at this date	o/d	1427	7	1
				9219	8	4					9219	8	4
Apr.	1	" Stock on hand brought down		1427	7	1							



Photo, Topley, Ottawa

TIMBER RAFT ON THE OTTAWA RIVER, CANADA

TIMBER-CUTTING IN A CANADIAN FOREST

As stated above, the goods on hand at the end of a trading period are valued at cost price for the purpose of ascertaining the gross profit earned. This being so, the reason for the method of dealing with the stock in the above manner in the goods account may be explained by means of the following illustration:—

The goods purchased amounted to ...	£7358	5	10
Those unsold had cost	1427	7	1
Therefore the cost price of those sold was	£5930	18	9
The credit side shows that the selling price of the goods sold was	7792	1	3
The difference between the cost and selling prices was, therefore, profit, viz. ...	£1861	2	6

Balancing the Ledger Accounts

This method of dealing with the goods account for balancing purposes is confined to that account. All other real and personal accounts are balanced by adding up both sides, finding the difference, and entering it on the lighter side, calling it "balance". The totals of both sides are then equal, and care must be taken to write them exactly opposite one another on the two sides. The totals are ruled off, and the balance is carried down to the opposite side to that on which it was first entered. A balance is known as either a debit or a credit balance, and takes its name from the side to which it is finally brought down. Thus the balances on the accounts of John Smith and Goods, shown above, are both debit balances.

Nominal Accounts

The third division of accounts, viz., nominal accounts, record gains, losses, and expenses of the business. The rule for making entries in them is that all losses and expenses are debited to the accounts provided for them, and all gains credited to their several appropriate accounts. At the end of a trading period the totals or balances of the various nominal accounts are transferred to one general account called the Profit and Loss Account, which shows the net result of carrying on the business. It would be possible to obtain this result by the use of the Profit and Loss Account only, but such a procedure would render it difficult for a trader to ascertain precisely the nature of his losses and expenses, and, to a lesser extent, of his gains. It would involve a laborious dissection of the account, which would be cumbered by all sorts of small items which are much more conveniently grouped in appropriate accounts of their own. This is one of the improvements brought about by modern developments, as in the early stages of the bookkeeping art the practice was to enter all gains and losses in the Profit and Loss Account as they accrued.

Examples of nominal accounts which are common to practically all businesses are: Salaries, Wages, Rent, Rates and Taxes, Carriage, Advertising, Repairs, Travelling, Stationery, Postages and Telegrams, Discount and Trade Expenses, the last named of which is usually an omnibus account in which are entered miscellaneous items — generally small in amount — which have no special account provided for them. It must be remembered that all these accounts are subsidiary to the general Profit and Loss Account to which the balances are transferred at the end of a trading period. There are many other nominal accounts peculiar to particular classes of undertakings, such as Directors' Fees in limited companies, Agents' Commission in insurance companies and other undertakings, Maintenance of Way, Locomotive Power, and Compensation for Accidents in railway companies, Interest allowed to Customers by Banks, Port and Light Dues payable by shipping companies, Licence Compensation Levies on brewers owning licensed properties. The following is a specimen of such an account common to most businesses:—

Dr. RENT, RATES, AND TAXES ACCOUNT *Cr.*

1911.				£	s.	d.	1911.				£	s.	d.
Jan.	8	To Cash—Income Tax, Schedule A	5	29	3	4	Mar.	31	By Transfer to Profit and Loss A/c.....	57	325	0	0
		„ Cash—Income Tax, Schedule D	„	125	0	0							
Feb.	3	„ Cash—General Rates for half-year to 31 March...	48	75	0	0							
Mar.	28	„ Cash—Rent to Lady Day ... £125 0 0 *Less* Tax ... 29 3 4	101	95	16	8							
				325	0	0					325	0	0

The general Profit and Loss Account would appear as follows:—

Dr. PROFIT AND LOSS ACCOUNT *Cr.*

1911.				£	s.	d.	1911.			£	s.	d.
Mar.	31	To Salaries and Wages.....	51	462	5	4	Mar.	31	By Gross Profit on Goods..	1861	2	6
		„ Rent, Rates, and Taxes	„	325	0	0			„ Discounts received.....	116	8	4
		„ Carriage.....	„	178	10	3						
		„ Discounts allowed	„	172	4	9						
		„ Advertising	„	69	5	0						
		„ Trade and Office Expenses.....	„	126	5	2						
		„ Repairs and Renewals	„	41	19	7						
		„ Bad Debts	„	75	8	3						
		„ Net Profit transferred to Capital Account...	„	526	12	6						
				1977	10	10				1977	10	10

Capital Account

The net profit shown on the Profit and Loss Account belongs to the proprietor of the business, who has invested his capital in the undertaking, and who would have to bear any loss on working that might be incurred. An account is kept in the ledger entitled the Capital Account, in which he is credited with the sums he has introduced as capital and with any profits earned. As against this, he is debited with all amounts he withdraws from the business and with any losses sustained. A Capital Account appears, therefore, in the following form:—

Dr. CAPITAL ACCOUNT *Cr.*

1911.				£	s.	d.	1911.			£	s.	d.
Jan.	31	To Cash—Drawings	48	100	0	0	Jan.	1	By Balance brought forward	5000	0	0
Feb.	28	„ „ „	78	100	0	0	Mar.	31	„ Net Profit	526	12	6
Mar.	31	„ „ „	103	100	0	0						
		„ Balance carried down....		5226	12	6						
				5526	12	6				5526	12	6

Balance Sheet

The objects of account-keeping are to enable a trader to ascertain with ease and certainty the nature and extent of his gains and losses, liabilities and assets (including debts owing to him by customers and others). The Profit and Loss Account gives him the required information on the first two points, and, for the purpose of showing at a glance what is his position with regard to assets and liabilities, a statement is prepared called a Balance Sheet, of which the following is a simple form:—

BALANCE SHEET

Liabilities	£	s.	d.	Assets	£	s.	d.
Trade Creditors.....	3781	9	2	Cash at Bank.....	987	10	6
Proprietor's Capital.....	5226	12	6	Cash in hand.....	14	5	1
				Stock of Goods.....	1427	7	1
				Trade and other Debtors.....	4986	19	7
				Machinery in Factory.....	1516	9	5
				Office Furniture.....	75	10	0
	9008	1	8		9008	1	8

The Balance Sheet, as its name implies, is a statement comprising the balances of all the accounts in the books of a business, and is prepared after the net profit or loss has been ascertained

and transferred to the capital account of the proprietor. It will be observed that it is divided into two parts—one for the assets, the other for the liabilities—so that the proprietor may see at a glance his commitments on the one hand, and what he has to meet them on the other. The difference between these two sets of items is the proprietor's capital, and must agree with the balance of his capital account in the ledger. If it should happen that the liabilities exceed the assets, the proprietor, instead of having capital, is insolvent, and this will be proved by his Capital Account showing him as a debtor instead of a creditor of the business. In such a case the balance of the Capital Account is entered on the assets side of the Balance Sheet. If the two sides do not agree, it is proof that there is an error in the books or that the principle of double entry has not been carefully observed.

DOUBLE ENTRY

Reference has already been made to the fact that the adoption of the present system of account-keeping known as double entry was inevitable as soon as the true nature of a transaction was recognized, viz., that every commercial dealing is a transfer of value, and that two persons, or things, must therefore be affected. For example, take the simplest form of commercial transaction—a purchase of goods of any kind for ready money. The stock of cash of the purchaser is reduced, while his goods have increased. It is not sufficient to show on his cash record that a payment has been made. His books must show that his stock of goods has increased, otherwise they do not state his true position. Similarly, if goods are sold on credit, it must be recorded in the accounts of the seller that property in the shape of goods has gone out of the business, and that another form of property, viz., a debt owing to the business, has accrued due to it. It is necessary, therefore, in order to record fully the effect of a transaction, to show on the accounts of both persons (or things) how their position has been altered by the event that has taken place.

It is obvious that in every transaction the value transferred is received by one person or account and sent or given by another; and as the receiver or receiving account is always regarded as the debtor and the sending account as the creditor, it is evident that if the record be correctly kept the total of the entries on the debtor side of the ledger accounts will at any given time equal the total of the credit entries. This is of great advantage to a merchant in showing him that, *prima facie*, his dealings have been correctly recorded, for the first essential of account-keeping is that it should be accurate. No other system enables this or any other trustworthy test to be applied, and it is mainly for this reason that double-entry book-keeping has been universally adopted.

TRIAL BALANCE

A test of the accuracy of the records in the books is applied in all businesses at regular periods, varying from the daily balancing in the case of banks, to a yearly test in the case of small and moderately sized undertakings. The procedure is to make a list of all ledger accounts, and to enter against each, in debtor and creditor columns, the total of the entries made on the respective sides of the accounts in the ledger. This is called a Trial Balance; and if the two totals—debit and credit—agree, it is evident that the transactions have been recorded on the proper sides of the ledger. The agreement of the Trial Balance is not conclusive evidence of the absolute accuracy of the books, but those errors which may exist, and are not disclosed by the Trial Balance, will be dealt with later and need not detain us now.

The practice of making up the Trial Balance from the totals of the entries on the ledger accounts was the method originally adopted, but the modern practice is to extract the balances only. This furnishes as good a test, and saves considerable labour by enabling the bookkeeper or accountant to exclude all accounts on which the entries on both sides are equal, or, as it is termed, when the account balances. The extraction of the balance on those accounts on which the entries on one side exceed those on the other, is as effective a test as taking the total of the entries, because the balance of the account is merely the excess of one side over the other; in other words, the same amount is omitted from both debtor and creditor sides, which does not, of course, affect the agreement of the totals.

The step of extracting a Trial Balance is most important in every business in furnishing the best test available of the accuracy of the accounts, and must never be neglected. It would be hopeless in an undertaking of any considerable size to obtain

a Balance Sheet enabling the trader to ascertain his financial position without first preparing a Trial Balance, for, however great the care exercised in keeping the books, errors are certain to creep in. These are detected by the Trial Balance, and can be corrected before the final accounts and Balance Sheet are prepared. In small concerns it might be possible to do without it and yet extract an accurate Balance Sheet from the books; but even in such a case so little time would be involved in extracting it, that the work would be well repaid by the knowledge, before proceeding to the Balance Sheet, that the accounts were correct.

SUBSIDIARY BOOKS

The Cash Book

The Cash Book is in many respects the most important of the subordinate books, owing to the nature of the transactions recorded in it. It differs from the usual subsidiary books in that it has both debtor and creditor sides. There are, of course, certain businesses in which subsidiary books are kept with two sides, e.g. Stock and Stores Books; but in an ordinary business the Cash Book is the only book, besides the ledger, kept in this manner. This is because the book is really a ledger account kept in a separate binding, for the reason that the large number of entries on a cash account in the ledger would entail the opening of new ledgers at short intervals, with the consequent labour of transferring the other accounts to the new book, unless a loose-leaf ledger were used, which would be very undesirable where a cash account is concerned. Being a ledger account the Cash Book is generally said not to be a subsidiary book, but is sometimes so regarded.

The best modern practice in commercial houses is to make all payments except petty cash payments by cheque, and to pay into the Bank daily all monies received. The principal advantages of this method are that payments can be made to creditors by means of cheques, which can be produced as evidence of payment in case of dispute, and the trader is relieved of the responsibility of keeping large sums of money in his office. When this method is adopted the following form of Cash Book is used, the Bank columns representing the ledger account of the Bank in relation to the trader, who would otherwise have to keep an account for the Bank in the ledger:—

Dr. CASH BOOK *Cr.*

Date.	Receipts.	Fol.	Discount.			Bank.			Date.	Payments.	Fol.	Discount.			Bank.		
1911.			£	s.	d.	£	s.	d.	1911.			£	s.	d.	£	s.	d.
Apr. 1	To Balance in hand...	b/d				456	8	1	Apr. 2	By G. White.....	296	1	6	6	51	13	6
" 3	" W. Brown—on a/c	81				50	0	0	" "	" S. Grey.....	253	2	18	0	58	2	0
" "	" F. Black.....	121	2	5	0	87	15	0	" 3	" C. Blew.....	301				100	0	0
" 4	" B. Green.....	115	1	2	6	43	17	6									

Discount

When discount is allowed either to or by a merchant in consideration of prompt payment, the fact is recorded in the Cash Book on the same side and line as the cash to which it relates. The effect of this is to make the discount column another ledger account. All cash received and discount allowed by the trader are entered on the left-hand or debtor side of the Cash Book. In order to preserve the principle of double entry the amounts of both cash and discount are entered, or posted as it is termed, to the credit side of the payer's account in the ledger, since he is a creditor in respect of this transaction. Similarly, all payments by the trader are entered on the credit side of this Cash Book, and posted, with any discount attaching to them, to the debtor side of each receiver's account in the ledger. For convenience of future reference, the number of the page or folio in the ledger to which the amount has been posted is entered in the narrow column to the left of the discount column. A similar column is provided in the ledger, as shown in the ledger accounts above, to indicate the folio of the Cash Book or other book from which the item was obtained.

Petty Cash Book

When the cash record is kept in this manner, i.e. all payments made by cheque and all receipts paid into the bank, the small payments made by the office for office expenses are entered in a book called the Petty Cash Book. This is too frequently

PETTY CASH BOOK

Date.	Receipts.	C.B. Fol.	Amount. £	s.	d.	Date.	Payments.	Total. £	s.	d.	Postages and Telegrams. £	s.	d.	Travelling Expenses. £	s.	d.	Carriage. £	s.	d.	Sundries. £	s.	d.	Ledger Accounts. £	s.	d.
1911.						1911.																			
April 1	To Cash	1	20	0	0	April 1	By Stamps	1	0	0	1	0	0												
						" "	" Carter Paterson		1	6								1	6						
						" "	" Taxi—South Kensington		3	6							3	6						
						" 2	" Ink and Paper		3	6										3	6			
						" "	" Stool—Furniture a/c		12	6												12	6
						" 30	" &c., &c.	15	0	0	3	12	8	5	14	4	2	18	2	1	14	10	1	0	0
							Total for month	17	1	0	4	12	8	5	17	10	2	19	8	1	18	4	1	12	6
							Balance in hand	2	19	0															
			20	0	0			20	0	0															
May 1	To Balance	b/d	2	19	0	May 1	By Telegram—Smith		1	1		1	1												
" "	" Cash (new cheque)	18	17	1	0	" "	" G.W.R.		3	2								3	2						

THREE-COLUMN CASH BOOK

Date.	Receipts.	Fol.	Discount. £	s.	d.	Office Cash. £	s.	d.	Bank. £	s.	d.	Date.	Payments.	Fol.	Discount. £	s.	d.	Office Cash. £	s.	d.	Bank. £	s.	d.
1911.												1911.											
June 1	To Balance in hand	b/d				81	3	11	243	9	5	June 1	By South Met. Gas Co.	25				14	11	3			
" "	" W. Burke—on a/c	85				100	0	0				" "	" Borough Council Rates	30				38	6	6			
" 2	" F. Byrne—Cheque	116	1	8	6				55	11	6	" 2	" W. Farrell—on a/c	251							100	0	0
" "	" C. Lever	94		15	0	29	5	0				" 3	" Bank	c				150	0	0			
" 3	" Office Cash	c							150	0	0	" "	" B. Driscoll	311	2	4	0				85	16	0
" "	" W. Crean	151	3	0	0				117	0	0	" 4	" Office Cash	c							50	0	0
" 4	" Bank	c				50	0	0				" "	" Wages as per Book	40				35	8	6			

kept in a very rough manner, rendering it difficult to place an effective check on the petty cash clerk. The method that should be adopted is to draw a cheque in the first instance for a round sum, estimated to be sufficient to meet the petty cash expenditure for a period of, say, one month, and to keep a record of the expenditure of the money in an analysed form day by day. At the end of a period of a month a cheque should be drawn for the exact amount of the expenditure, and this, with the amount remaining in the hands of the petty cash clerk, will restore his balance to the amount originally drawn, which he thus has in hand at the commencement of each month. The form of Petty Cash Book used under this method is shown on p. 111.

The totals of the several columns, except the last, are posted to accounts provided for them in the ledger which are closed at the end of the year by the transfer of the balances to the Profit and Loss Account. This saves a great deal of labour otherwise necessary to post many small items separately to ledger accounts.

Three-column Cash Book

In undertakings where all money received is not paid into the Bank, and where payments of substantial amounts are made in cash, an additional column is provided in the Cash Book, which is then ruled as shown on p. 111. In such a case all money received and paid by the office is entered in the Office Cash column, and posted to the credit and debit respectively of the ledger accounts of payers and receivers. When cash in the office is paid into the Bank two entries are required in the Cash Book, as shown above on June 3, for as the Office Cash pays the amount it must be credited in the Office Cash column, and as the Bank receives the money it must be debited. On the same ground, when money is drawn from the Bank to replenish Office Cash, the Bank must be credited and Office Cash debited, as shown above on June 4. When money is paid into the Bank as soon as received, it is entered direct into the Bank column, as shown under June 2 and 3 on p. 111.

Reconciliation with Pass Book

The Bank columns in both the above forms of Cash Book must agree, or be made to agree, with the Bank Pass Book. At the end of the year the balance shown by the Cash Book will probably not agree with the balance of the Pass Book. This is due to either or both of two causes. Cheques which have been drawn and sent to the payees during the day or two immediately preceding the close of the year, may not have reached them in time for presentation before the close of business on the last day of the year, and therefore will not be entered in the Pass Book as paid. As they were entered in the Cash Book as payments when they were drawn, this will create a difference between the Cash Book and the Pass Book. On the other hand, cheques received by the business on the last day of the year, may not have been entered in the Pass Book as received until they were collected by the Bank a day or two later. This will cause a further difference. To show why these balances do not agree, the Pass Book must be checked with the Cash Book to ascertain which items in the latter do not appear in the former. A statement called a Reconciliation Statement is then prepared in the following form, and is usually entered in the Cash Book on the page on which the entries for the last day of the year are made:—

RECONCILIATION STATEMENT

1911.						
Dec. 31.	Balance as per Bank Pass Book ...				£586	17 2
	Add—					
	Cheques paid in but not credited, viz.:					
	F. Summer ...	£61	8	3		
	C. Winter ...	21	9	5		
					82	17 8
					£669	14 10
	Deduct—					
	Cheques drawn but not yet presented, viz.:					
	G. Weeks ...	£52	8	0		
	M. Dey ..	111	2	9		
	S. Millen ...	21	0	0		
					184	10 9
	Balance as per Cash Book ...				£485	4 1

Grouping of Transactions

The ordinary transactions of any business or profession are naturally all of the same character in a particular undertaking. Thus a wholesale trader is constantly purchasing goods from manufacturers and selling to retailers. A manufacturer buys raw material, and makes and sells the manufactured article. A solicitor gives advice or other legal services, and renders bills of costs to clients. The receipt and payment of cash is common to all of them, and the method of recording the cash transactions has already been explained. As the dealings of a business thus run on well-defined lines, they lend themselves readily to grouping for entry in the books of account. Instead of each transaction being dealt with separately and debited to one account and credited to another, all

dealings of a similar nature are gathered together and, as far as possible, entered in the ledger in one amount. By far the greater number of businesses carried on to-day are concerned in the purchase and sale of goods. It will be convenient, therefore, to deal in the first instance with the method of entering transactions relating to those undertakings.

Purchases Book

The great majority of commercial transactions are entered into on a credit basis, and this is particularly so in the case of purchases of goods by traders. A special book is, therefore, used to record all purchases of goods on credit. This is called the Purchases Book, Purchases Journal, Bought Book, or Invoice Book in various businesses, but the details entered in it are of the same nature whatever the book is called. The form of the book and the method of keeping it are the same in nearly all offices. It is ruled as follows:—

Date.		Particulars of Purchase.	Folio.	Amount of each Parcel. £	s.	d.	Total of Invoice. £	s.	d.
Jan.	3	A. Smith:							
		455 yd. Black Velvet (A 520) at 9*s.* 6*d.*.....		216	2	6			
		996 yd. Green Surah Silk (F 230) at 5*s.* 3*d.*....		261	9	0			
				477	11	6			
		Less Trade Discount at 15 %.....	181	71	12	6			
							405	19	0

This specimen entry almost speaks for itself, and explains the use of the book so far as the entering of it is concerned. Full details as to description, quantity, quality, and price of the articles bought should be entered in the second column, each parcel included in the purchase being separately set out, and the amount thereof entered in the first cash column. The total of the parcels, after deduction of any trade discount, is extended into the second cash column. The particulars thus entered are obtained direct from the invoices for the goods. It will be observed that any trade discount allowed is deducted in this book, and must not be confused with any cash discount subsequently allowed for prompt payment, which is entered in the Cash Book.

The entries in the Purchases Book do not in themselves constitute either a debit or a credit entry on the accounts. They are made here in preparation for debiting and crediting accounts in the ledger subsequently. The persons and firms whose names appear in this book are, obviously, creditors of the business. This furnishes the key to the posting of the Purchases Book entries to the ledger. Day by day the amounts in the second cash column are posted to the credit side of accounts opened in the ledger in the names of persons who have supplied the goods. One side of the transactions as they affect the trader is thus brought into account. Periodically, usually at the end of each month, the second cash column is totalled and the amount posted to the debtor side of a Purchases Account in the ledger. This completes the double entry of the purchases, and complies with the rule previously mentioned that the receiving account is always debited and the sending account credited.

It will be apparent that the saving of labour by the introduction of the Purchases Book in a business of considerable size is enormous. Instead of thousands of entries being made on the debtor side of the Purchases Account, one only is required each month. No details of the purchases are entered on the ledger accounts, which is another great saving. If full particulars of a transaction are required, reference to the Purchases Book, giving all details, is made easy by the insertion of the folio in the usual column. The Purchases Account here mentioned is a modern development of the old Goods Account which formerly contained not only purchases and sales but any returns and allowances in connection with them. This made the account somewhat cumbrous, and not so useful as it might have been for furnishing information as to the amounts of the total purchases and sales during a given period. The modern practice, therefore, is to keep separate accounts for the purchases, sales, returns and allowances, and to transfer the totals or balances of them to a general account, called the Trading Account, at the end of each year.

Departmental Purchases Book

Many concerns are divided into several departments, and in such cases the proprietor desires to know the result of the trading of each. To effect this a separate account must be kept for each de-

partment, and as a first step the goods bought for them must be separately charged. To enable this readily to be done, the Purchases Book is ruled so that the purchases can be classified and the several departments debited with those which they receive. A specimen of such a book is given below.

ANALYSED PURCHASES BOOK

Date.		Particulars of Purchase.	Fol.	Total of Invoice.			Hosiery.			Gloves.			Ties, &c.			Shirts and Collars.		
1912.				£	s.	d.	£	s.	d.	£	s.	d.	£	s.	d.	£	s.	d.
Jan.	1	T. & R. Worley:																
		1 Gross Lamb's-wool Vests at 54s. per doz.					32	8	0									
		1 Gross Lamb's-wool Pants at 45s. per doz.					27	0	0									
		1 Gross Merino Vests at 33s. per doz.					19	16	0									
		1 Gross Merino Pants at 30s. per doz.					18	0	0									
		2 Gross Dress Shirts at 46s. per doz.														55	4	0
		1 Gross Regatta Shirts at 36s. per doz.														21	12	0
		1 Gross Oxford Shirts at 32s. per doz.														19	4	0
		6 Gross Collars, assorted, at 4s. per doz.														14	8	0
		6 Gross Half-hose, assorted, at 9s. per doz.														32	8	0
			170	240	0	0												
"	3	Bent & Co.:																
		3 Gross assorted Men's Gloves at 18s. per doz.								32	8	0						
		6 Gross assorted Ladies' Gloves at 16s. per doz.								57	12	0						
			194	90	0	0												
"	6	Jenkins & Sons:																
		½ Gross Silk Scarves at 36s. per doz.											10	16	0			
		½ Gross Braces at 6s. per doz.											1	16	0			
			201	12	12	0												
"	31	&c., &c., during month		315	8	0	81	2	6	94	8	6	71	8	0	68	9	0
		Total for month		658	0	0	178	6	6	184	8	6	84	0	0	211	5	0

The posting of this book, so far as creditors are concerned, is carried out in precisely the same manner as that of the ordinary Purchases Book; but instead of the total of all the purchases being posted to the debit of a Purchases Account in the ledger, the totals of the analysis columns are posted either to the debit of their respective accounts opened in the name of each department, or they are posted to a Purchases Account provided with similar columns to those in the Purchases Book. If the latter course be adopted the totals are transferred at the end of the year to the departmental accounts, which embrace all the other items in the books affecting the working of the various departments. These accounts are more particularly dealt with in the Chapter on Branch and Departmental Accounts.

Sales Book

A book ruled in a similar manner to the simple form of Purchases Book shown above is used to record sales made on credit. The method of making entries in it is precisely the same as for the Purchases Book, the details being obtained from duplicates or press copies of invoices sent to customers. The posting of the book to the ledger is the reverse of the Purchases Book. The buyers of the goods are debtors to the business, and are debited with the total of each invoice on accounts opened in their names in the ledger. The monthly total is credited to a Sales Account, thus completing the double entry of the month's transactions. If the proprietor keeps departmental accounts, the book is ruled and entered in the same manner as

the analysed Purchases Book shown above. The only alteration is in the treatment of the monthly totals for posting purposes, such postings being made to the credit of the departmental accounts.

Returns Books

It happens in every business that, for a variety of reasons, goods are returned both by and to the business. They are not in accordance with order, not up to sample, damaged, or in excess of the quantity ordered. A careful record must be kept of all goods so returned, and entries made in the books of account to show the effect of such returns. The commercial practice is to treat each return as a transaction in itself, and not to deduct the price of the goods from the original record of the purchase or sale. Goods returned by a trader to a wholesale dealer or manufacturer are known to the trader as Returns Outward. A book is set aside specially to record them, ruled in the same way as the Purchases Book, for the reason that the entries to be made and the goods returned relate directly to entries originally made in the Purchases Book. The book is called the Returns Outward Book, and the entries in it set out details of the goods returned, in the same manner as the original entry in the Purchases Book. If there is more than one parcel the amount of each is entered in the first cash column and the total extended into the second. A concise statement of the reason for the return is made under the description of the goods. The entries are posted separately to the debit of the persons to whom they are returned, and the monthly totals are posted to the credit of a Returns Outward Account which is opened in the ledger for the purpose. Double entry is thus effected.

Returns of goods to a business are known as Returns Inward, and are entered in a book similar in all respects to the Sales Book, because the entries to be made in it will be in respect of the sales which have previously been entered in that book. The particulars of the entries give the name of the sender, quantity, description, price, and amount of the goods, and a short statement of the reason for the return, just as in the Returns Outward Book. The entries are posted to the credit of the persons returning the goods, and the monthly totals to the debit of Returns Inward Account. The two Returns Accounts thus operate as set-offs against the Purchases and Sales Accounts.

When goods are returned by one person to another the receiver sends a credit note to the sender, showing in the same form as an invoice the goods returned and the amount allowed in respect of them. These are usually printed in red ink, and must agree with the entries in the Returns Inward Book.

In some cases, when goods bought or sold are damaged or are not in accordance with the original order, an arrangement is made between buyer and seller that an allowance off the price shall be made to the purchaser, to obviate the necessity of returning the goods and so save expense. When this is done, a record of the fact must be made in the books. In the case of the person making the allowance, the entries will be to debit an Allowances Account and to credit the person retaining the goods, who, in his own books, will debit the seller and credit an Allowances Account. When allowances of this kind are few in number the entries may be passed through the journal in the first instance, and posted from there to the ledger. If, however, they are numerous, a special book is used, ruled like a Returns Book, and posted in the same manner, according to whether the allowances are to or by the business.

Bills of Exchange

Other transactions which can usefully be grouped for entry in the books of account, and which are so treated in practice, are those relating to bills of exchange. The dealings in bills are very numerous in many businesses, where it is the practice to give and receive them for goods bought and sold on credit. The nature of these documents, and the rights and liabilities of persons dealing with them, have been explained in a previous section. It will be convenient, however, to summarize here the features of bills, and to state the commercial practice with regard to them, particularly their record in a merchant's books. They were purely commercial documents in their origin, and have, in the main, retained their character. (See Part III, Chapter VII.)

In practice, commercial bills are nearly always made out in favour of a person named, and are payable some time ahead, three months being very usual; but this is a matter of arrangement between debtor and creditor. The bill, when drawn, i.e. made out, is sent by the drawer to the person to whom it is addressed, the drawee, who, after satisfying himself that it is in accordance with the arrangements between them, signifies his assent to the terms by acceptance. He then returns the bill to the drawer, who may do one of several things with it. He may retain it until maturity, and then present it for payment at the place named in the acceptance; or he may pass it on to one of his creditors in payment or part payment of a

debt; or he may take it to his banker and get cash for it, subject to the deduction of a small charge, called discount, made by the banker for advancing the money before it is due. The acceptor of the bill having parted with it, does nothing further, as a rule, until it falls due, when he pays it at the place named in the acceptance.

On the drawer parting with a bill in either of the ways mentioned above, it is necessary for him to sign his name on the back of it, unless it is payable to bearer. This is called endorsing the bill. The endorsement may be mere signature only, or the signature may be preceded by a direction to pay to a specified person or firm. The former is a general, the latter a special, endorsement. The transfer of a bill from one holder to another is termed negotiating the bill, whether the transfer be to a banker negotiating it or to another person in the ordinary course of business. Persons receiving bills of exchange in good faith and for value obtain the protection which the law extends to all those dealing with negotiable instruments. Their rights in the bill and in the proceeds thereof are not defeated by any defect in the title of any previous holder. It is this security which has largely influenced the commercial community in using them in such large numbers.

Bills fall naturally into two groups: those which the merchant has to pay, which are called Bills Payable, and those of which he receives the proceeds, called Bills Receivable. The practice of giving bills in settlement of credit dealings has much to recommend it. The amount of the debt is determined; the liability of the debtor is acknowledged by him, and a definite date for payment is fixed. These are important advantages for a trader to possess, and it is no matter for surprise that they are obtained when possible. There is a further advantage, the statement of which seems a contradiction, viz., that while the buyer of goods gets his full term of credit, the seller receives the price of the goods. This is because of the facilities granted by bankers for discounting bills. Further, a bill of exchange with a responsible acceptor is treated by the commercial community as cash, and transferred from trader to trader several times before it arrives at the due date for payment.

It is necessary, in those undertakings in which the bills given and received are numerous, to have special books in which to record full particulars of them. There are so many facts comprised within the words of a simple three months' bill, that to state them in a ledger posting would occupy too much space. As it is absolutely necessary to have a record of all details of bills, specially ruled books are used to record them in the first instance. From the records thus made, the effect of the bill transactions is posted to the ledger.

It might be thought that as the giving of a bill is a mere matter of arrangement between debtor and creditor, and, in effect, an acknowledgment of an existing liability, no entry would be necessary in the ledger, and that it would be sufficient to treat the bill, until it became due, as a security for payment, dealing with the cash then paid or received in the ordinary way. This would not be sufficient, because, to take first the case of a Bill Receivable, the bill might be received from a debtor who is not the acceptor of it, and who will not, therefore, be the person to whom to look for payment at maturity. To put it another way, the debtor discharges his liability when sending the bill, and must be credited with having done so. The Bill Receivable represents the liability of the acceptor to the business, although, as stated in an earlier chapter, the drawer and endorsers are sureties for him in case of his default. In the case of a Bill Payable, also, the giving of the bill affects the acceptor in a different manner from the handing over of a security to a creditor. If the bill remained in the hands of the drawer until maturity the position would not be changed, but if it should be negotiated, there would be somebody else entitled to receive payment at the due date. The giving of an acceptance is, therefore, always treated as a discharge of the original debt from the accounting point of view, and as the creation of a new liability to the holder of the bill for the time being.

Bills Receivable

In view of the considerations above stated, entries are made in the ledger cancelling the original debt whenever a bill is given or received by a trader. In the case of a Bill Receivable the sender of the bill is credited, and an account entitled the Bills Receivable Account is debited. The latter account will, in the course of a month, be debited with a considerable sum in a business in which bills are in common use. This amount represents an asset of the concern, in the form of bills which will be paid to it when they fall due. From another point of view it is an omnibus personal account representing the liability of the acceptors of the several bills the business holds. It would involve considerable labour to record each bill as it was received, on the debtor side of the Bills Receivable account, and it would be impracticable to enter there the full details required. A Bills Receivable Book is, therefore, used in which are entered full particulars of every bill received by a trader. The form of a Bills Receivable

Book is generally as follows, although modifications may be introduced to meet the requirements of special businesses. (See table on p. 118.) The particulars are obtained from the bills themselves, care being taken to allow for the three days of grace when calculating the date of maturity.

Each bill as it is received is entered in the Bills Receivable Book, and the amount thereof posted to the credit side of the ledger account of the person or firm from whom it was received, the ledger folio being entered in the Bills Receivable Book in the column provided for the purpose. Periodically, usually once a month, the total of the bills received is posted to the debit of a Bills Receivable Account in the ledger. Double entry is thus effected and much labour saved by making only one entry on the debtor side of the ledger, in place of the many that would be required if each bill were posted separately to the Bills Receivable Account.

As the Bills Receivable Account is debited with all bills received, it must be credited with all bills which are sent out. The majority of the Bills Receivable will go out when they are paid by the acceptors, to whom the bills are handed in exchange for cash. As previously mentioned, it is the practice for the acceptor to word the form of acceptance in such a manner as to make the bill payable at his bankers'. This makes it convenient for the holder of a bill to hand it to his own bankers for collection a few days before it arrives at maturity. When this is done the Bank is treated as having received the amount of the bill, which is entered in the Bank column on the debtor side of the Cash Book, and posted from thence to the credit side of the Bill Receivable Account. If a bill should be discounted before the due date, the amount received from the discounter is entered in the Cash Book in the Bank or Office Cash column as the case may be, the discount charged being also entered there on the same line in the appropriate column, both items being posted to the credit of the Bills Receivable Account. If a bill, instead of being discounted or held until maturity, is passed on to a creditor, his account must be debited and the Bills Receivable Account credited. It will be seen that in every case the Bill Receivable Account is credited with the amount of the bill, the reason being that that account is the sending account, value having gone out from it on each occasion.

It will be observed that in the remarks column of the Bills Receivable Book, shown above, one of the bills is stated to have been dishonoured. This is the term applied to the failure to meet a bill at maturity. Such failure revives the liability of the person from whom the bill was received by the holder, and necessitates further entries being made in the books of account. Instead of property in the form of a Bills Receivable the holder has a book debt due from an individual, and it is necessary to record this fact in the books. Entries are therefore made debiting the individual and crediting the Bills Receivable Account, because the individual has become the debtor owing to the bill not having been paid, while value has gone out of the Bills Receivable Account. Particular note should be made that the person to be debited is the one from whom the bill was received—not necessarily the acceptor—although in most cases they will probably be identical. If the bill has been paid into the Bank for collection and debited to the Bank, care must be taken to credit the Bank and not the Bills Receivable Account. The procedure necessary, in case of dishonour, to protect the rights of the holder of the bill against the acceptor, drawer, and endorsers has been explained elsewhere (Part III, Chapter VII).

When a bill has been dishonoured, a new bill is sometimes given in its place. In other cases also, instead of a bill being met at maturity an arrangement is made by the acceptor with the holder to withdraw it and substitute another. This is called renewing the bill. In either case interest is usually charged by the holder, and included in the amount for which the new bill is drawn. The entries necessary to record these transactions are (1) To debit the acceptor with the old bill, and credit the Bills Receivable Account; (2) to debit the acceptor, and credit Interest Account with the interest charged; and (3) to enter the new bill in the Bills Receivable Book, from which it will in due course be posted to the debit of the Bills Receivable Account (in the monthly total), and credited to the acceptor.

Bills Payable

Bills Payable are those acceptances which have been given by a trader to or at the request of his customers. When the bill has been accepted and returned to the drawer, the acceptor debits the account of the creditor, and credits a Bills Payable Account. The latter account is credited with all bills as they are given, and when acceptances are granted in large numbers the amount involved is considerable. The total amount credited to the account represents the aggregate liability of the trader to the holders of the bills. The same considerations which prompt the keeping of a Bills Receivable Book operate to make the use of a Bills Payable Book almost a necessity in those concerns where bills are largely used. The table on p. 118 is a general form, although, as in the

BILLS RECEIVABLE BOOK

No. of Bill.	Date Received.	From Whom Received.	Drawers.	Acceptors.	Where Payable.	Date of Bill.	Tenor.	When Due.	Led. Folio.	Amount of Bill. £	s.	d.	Remarks.
	1911.												
1	Jan. 2	F. Smith...	Selves.....	F. Smith...	Lloyds, Fleet St....	Jan. 1	3 mos.	4 Apr.	61	115	10	0	Paid.
2	" 6	W. Brown	W. Brown..	A. Jones...	Coutts'.....	" 3	2 "	6 Mar.	85	77	3	0	Discounted 7/1/11.
3	" 7	F. Soames..	Selves.....	F. Soames..	L. C. & W., Strand	" 5	3 "	8 Apr.	110	98	12	0	Paid.
4	" 8	W. Grey...	S. Black....	N. Green...	Birkbeck.....	" 4	6 "	7 July	93	118	5	0	Dishonoured.
5	" "	S. Slim.....	G. Frank...	B. Moore...	Midland, Borough...	Dec. 28/10	3 "	31 Mar.	82	26	8	0	Paid.
6	" 9	C. Main....	Selves.....	C. Main....	Hoare's.....	Jan. 6	3 "	12 Apr.	79	35	16	8	Paid.
						Further Bills during month			—	1387	14	4	
								Total for month	51	1859	9	0	Posted to Dr. of B. R. A/c.

BILLS PAYABLE BOOK

No. of Bill.	Date Accepted.	Drawer.	In Whose Favour.	Where Payable.	Date of Bill.	Tenor.	Due Date.	Folio.	Amount of Bill. £	s.	d.	Remarks.
	1911.											
1	1 Jan.	D. Johnson.....	D. Johnson.....	Parr's	30 Dec./10	3 mos.	2 Apr.	216	95	4	6	
2	—	E. Wilson	E. Wilson	"	31 Dec./10	"	3 "	231	48	2	6	
3	2 Jan.	F. Moylan.....	E. Williams.....	"	1 Jan.	"	4 "	285	116	10	0	Taken up under rebate 4 Feb./11.
4	3 "	W. Medhurst.....	C. Hyem	"	2 "	"	5 "	251	26	8	0	
5	—	E. Newbold.....	E. Newbold.....	"	2 "	"	5 "	218	45	10	0	
					Further Acceptances during the month			—	1741	12	6	
							Total for month	95	2073	7	6	Posted to Cr. of B. P. A/c.

case of Bills Receivable, modifications are sometimes introduced. The details of the bills are entered after they have been accepted, and before they are sent back to the drawers.

The posting of the book is the reverse of that of the Bills Receivable Book. The persons to whom bills have been given are debited separately with the amount of the bill each has received, while the total at the end of each month is posted to the credit of the Bills Payable Account in the ledger. The double-entry principle is thus observed, the one entry on the credit side equalling all those on the debit side.

As the bills payable come back to the acceptor they are debited to the Bills Payable Account, so that the balance on the account at any moment represents the liability of the trader in respect of his own acceptances. By far the greater number of the bills will be received back as the result of having been paid in the ordinary course at maturity. It is the practice of merchants to authorize their bankers to honour all acceptances made payable at the Bank, and lists of acceptances falling due in the course of each month are generally sent to the banker for his convenience. As the bills are presented by the holders for payment the banker pays them and charges his customer in his Pass Book. The amounts paid will be entered by the trader on the credit side of the Cash Book, and be posted to the debit side of the Bills Payable Account. The only cases in which bills do not come back to the acceptor in this way are when he pays them before maturity in consideration of an allowance called a rebate, or when he arranges for a renewal subject to the addition of interest in the new bill. The former operation is the reverse of discounting a Bill Receivable. The cash paid appears on the credit side of the Cash Book with the amount of the rebate allowed by the holder, and both amounts are posted to the debit of the Bills Payable Account. In the case of renewal the amount of the old bill is debited to the Bills Payable Account and credited to the holder, who becomes a creditor of the business on a personal account for the amount. He is also credited with the amount of the interest to be allowed him, the Interest Account being debited. The new bill is entered in the Bills Payable Book and posted to the debit of his account, and to the credit of the Bills Payable Account in the monthly total.

The Journal

The subsidiary books already explained comprise those in general use, but there are others employed in undertakings where the transactions are of such a nature as to lend themselves to grouping and analysis before being entered in the ledger. The further subsidiary books are better dealt with, however, in connection with the distinctive features of the particular businesses in which they are used. It is a cardinal principle of bookkeeping that no entry should be made in the ledger that has not passed through some other book first. The subsidiary books which have been dealt with are used exclusively for recording transactions of the particular kind for which they were designed, but there are many dealings in a merchant's business which do not fall within the categories to which those books relate. In order, therefore, to preserve the principle mentioned, it is necessary to have a book or books in which transactions not suitable for entry in the usual subsidiary books may be entered and prepared for transfer to the ledger. This function is fulfilled by the journal, which has survived the countless changes that have taken place in account-keeping, although its uses have been gradually but very largely curtailed by the introduction of the several subsidiary books mentioned above.

In modern practice the use of the journal is confined to recording transactions which may be classified under three heads, viz. (1) dealings which cannot conveniently be entered in any of the other books of original entry; (2) transfers from one book or account to another; and (3) opening and closing entries at balancing periods. In recording these entries two of the chief purposes served by the journal are to prepare the record for entry in the ledger by distinguishing which account is to be debited and which credited, and to give a fuller account of the matters entered in it than is possible in the ledger. To facilitate the carrying out of the first purpose, the journal in its common form is ruled with two sets of cash columns, one for debit, the other for credit entries. The transactions are stated in a manner to show at a glance the effect of each entry, the account to be debited being always stated first. The second purpose is effected by a short explanation of the entry in the journal being written immediately underneath it. This explanation is, in accounting language, called a narration. The usual form of journal and the method of making entries in it are given on p. 120.

The first of the journal entries illustrates the function of the journal in preparing items for posting to the ledger. It would be possible to open ledger accounts for each of the assets and liabilities, and to enter therein the respective amounts relating to them, but there would be a great danger of omitting one or more of the items unless they were set out in some such manner

JOURNAL

1911.				C. B.	£	s.	d.	£	s.	d.
Jan.	1	SUNDRIES—	*Dr.*							
		To Sundries—								
		Cash at Bank		1	193	19	11			
		Stock		100	272	11	2			
		Business Premises		20	1400	0	0			
		Bills Receivable		80	341	8	6			
		F. Hill		201	82	1	8			
		W. Boon		205	35	10	0			
		Bills Payable		150				128	6	3
		H. Wills		171				45	8	4
		J. Briggs		173				23	2	1
	1	Capital		1				2128	14	7
		For Assets, Liabilities, and Capital on commencing business.								
"	4	Brown & Son	*Dr.*	216	37	10	0			
		To Commission Account		50				37	10	0
		For Commission at 5 % payable on sale of cotton piece goods for £750.								
"	8	Brownjohn & Co.	*Dr.*	226	37	10	0			
		To Brown & Son		216				37	10	0
		For Commission chargeable to former, but debited in error to latter, now transferred.								
June	30	PROFIT AND LOSS ACCOUNT	*Dr.*	400	448	4	10			
		To Sundries—								
		Salaries		60				231	10	0
		Rent, Rates, and Taxes		65				86	9	6
		General Expenses		70				130	5	4
		For Balances transferred.								
"	30	SUNDRIES—	*Dr.*							
		To Profit and Loss Account		400				707	1	9
		Commission		50	37	10	0			
		Discount		55	46	3	4			
		Trading Account		400	623	8	5			
		For Balances transferred.								

as above, indicating clearly the accounts to be debited and credited. It will be observed that all assets are entered in the debtor column, and in posting them to the ledger they are entered on the same side of the accounts which receive them. The liabilities, including that of the business to the proprietor for his capital, are shown in the credit column, and are posted to the credit side of their respective ledger accounts. This is the rule always to be observed in making what are called the opening entries of a business, the assets being debited and the liabilities credited.

The second entry in the journal is an example of a transaction which cannot be entered in any of the usual subsidiary books, and is therefore passed through the journal. It is obviously not suitable for either Cash Book, Purchases Book, Sales Book or Bills Book, and consequently finds a resting-place in the journal. In posting to the ledger the entries are made as directed in the journal entry, the account of Brown & Son being debited and Commission Account credited.

The third entry shows the use to which the journal is put to record transfers. It has been ascertained that the wrong firm have been charged with the commission and it is necessary to rectify the error. This is done by making the entry on the opposite side of the account which was first debited, thus nullifying the entry, and entering the amount on the debtor side of the correct account. It would, of course, be possible to make these entries without passing them through the journal, but the danger of making one entry only is not inconsiderable, and is reduced to a minimum by making the entries in the journal in the first instance.

The fourth and fifth entries show how the balances on the various accounts of expenses and income are collected at the end of a trading period into the general Profit and Loss Account, and are illustrations also of recording transfers from one or more ledger accounts to another.

When posting all the above entries to the ledger, care is taken to insert in the folio column the folio

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REFERENCE NOTE TO COLOURING

- Regions at present engaged in International Commerce
- Regions capable of Commercial Development, but at present undeveloped
- Regions open to Commercial Enterprise only during Summer months
- Barren and Desert Regions incapable of Commercial Development

John Bartholomew & Co. Edin.r

REFERENCE NOTE TO COLOURING
Regions at present engaged in International Commerce
Regions capable of Commercial Development, but at present undeveloped
Regions open to Commercial Enterprise only during Summer months
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ARCTIC OCEAN
Taimyr Peninsula
New Siberia
Kara Sea
SIBERIA
RUSSIAN EMPIRE
Sea of Okhotsk
Bering Sea
Kamchatka
ASIA
MONGOLIA
MANCHURIA
Desert of Gobi or Shamo
TURKISTAN
EASTERN TURKISTAN
CHINESE EMPIRE
TIBET
CHINA
PERSIA
AFGHANISTAN
BOKHARA
INDIA
BURMA
SIAM
Peking
Japan
Sea of Japan
HONDO
JAPAN
Hong-Kong
Formosa
Luzon
Philippine Islands
PACIFIC OCEAN
Ladrone Is.
Caroline Islands
Marshall Is.
EAST INDIES
Borneo
Celebes
Moluccas
Dutch New Guinea
Bismarck Archip.
Solomon Is.
Coral Sea
New Hebrides
New Caledonia
FIJI Is.
INDIAN OCEAN
Arabian Sea
Bay of Bengal
Ceylon
Bombay
Madras
Calcutta
Karachi
Seychelles
Mauritius
Reunion
Chagos Archipelago
Diego Garcia
Cocos or Keeling Is.
Christmas I.
WESTERN AUSTRALIA
NORTHERN TERRITORY
SOUTH AUSTRALIA
QUEENSLAND
NEW SOUTH WALES
VICTORIA
TASMANIA
NEW ZEALAND
Auckland
Wellington
Christchurch
Dunedin
Hobart
Melbourne
Sydney
Brisbane
Perth
Adelaide
Darwin
Norfolk I.
Lord Howe I.
Tropic of Cancer
Tropic of Capricorn
Equator
Yokohama to Vancouver 4320 m.
Yokohama to San Francisco 4750 m.
Mauritius to Melbourne 4590 m.
Cape Town to Hobart 5838 m.
Marseilles to Sydney 11000 m.
Colombo to Aden 2400 m.
Aden to Suez 1300 m.
Colombo to Penang 1200 m.
Colombo to Aden 3450 m.
Colombo to Albany 5247 m.
Sydney to Auckland 1284 m.
Sydney to Wellington 1240 m.
Auckland to Suva 1300 m.
Amsterdam I.
St. Paul I.
Kerguelen I.
Heard I.
Northern Limit of Drift Ice
Southern Limit of Drift Ice
East of 155 Greenwich

of the ledger to which the item has been posted. This affords a check upon each of the amounts finding its proper destination. In the ledger is inserted the folio of the journal on which the entry first appeared, so that reference back for full particulars of the transaction is easy.

Although the journal is confined in modern practice to the purposes mentioned above, it must be understood that every transaction in any business is capable of being stated in the form of a journal entry. The recollection of this fact may prove of considerable assistance, in case of difficulty, when doubt arises as to which accounts to debit and credit to record a complicated transaction. Solution will be materially assisted by a journal entry being drafted to give effect to the transaction, as the putting into writing of the first ideas will show whether or not the desired effect will be produced by carrying them into the ledger. Alteration is easy, and the correct entries will be much more readily obtained than by ledger entries, even if drafted.

Bad Debts

There are certain transactions which necessitate the use of more than one book of original entry, because two distinct events take place in connection with them. As an illustration the case of bad debts may be taken, as they occur with more frequency, unfortunately, than others. In this case, too often there is one event only to record—the total loss of the whole amount owing. When this happens, only one book is brought into use, the journal, in which an entry is made debiting a special account, called the Bad Debts Account, and crediting the defaulting debtor. In some cases, however, a dividend or composition is paid from the debtor's estate, so that while part of the debt is paid the balance is lost. The cash received is entered on the debit side of the Cash Book in the same way as the ordinary receipts, and posted to the credit of the debtor's account. The balance which is bad is passed through the journal as above described. This is posted to the ledger in the usual way, so that the two credit entries which are posted from the Cash Book and Journal respectively to the debtor's account will extinguish the debt previously standing there as owing by him. This is, of course, necessary, as, if the cash only were credited to him, he would still appear as a debtor for the balance, and be extracted with the other debtor balances when making up the Balance Sheet, and so go to swell the assets fictitiously. The debits entered on the Bad Debts Account during a trading period are transferred to the Profit and Loss Account at the end of the period in one sum, in the same way as the balances of the other subsidiary Profit and Loss Accounts.

CLASSIFICATION AND ORGANIZATION OF ACCOUNTS

The ledger and subsidiary books, the uses and keeping of which have been explained in the foregoing chapters, may be taken as typical of those in use in an ordinary business where buying and selling goods is the basis of the undertaking. In other concerns further or different subsidiary books may be necessary, but these are considered in detail in a later Chapter of this Part. It will be convenient, however, to deal here with the classification and organization of accounts generally, it being clearly understood that the system of bookkeeping must always be that of double entry.

Counting House Rules

The means to be employed to ensure the regular and efficient keeping of the books will vary in detail in every business, but the following general rules may be laid down for the guidance of the head bookkeeper in all cases:—

1. All cash and remittances received should be paid into the Bank the day they are received, and all payments should be made by cheque except those for petty expenses.

2. A receipt book with counterfoils should be furnished for cash received, and the counterfoils must show at least the customer's name and the amount paid. Vouchers should be obtained for all payments.

3. The Cash and Bank Pass Books should be compared at least once a month and the balance verified. If necessary, a reconciliation statement must be prepared in the manner shown on p. 112.

4. Wages sheets made up to Thursday night should be submitted by the head of each department, showing the men employed, the number of hours, the rate per hour, the gross amount due, any deductions, and the net amount payable. A cheque should be drawn for the total amount, and the sums due for each department handed to the head, who must obtain the signature of each employee for the amount paid to him.

5. Petty Cash to be kept on the imprest system in a book similar to that shown on p. 111 and balanced once a week, the items being scrutinized by somebody other than the petty-cash clerk. A limit should be placed on petty-cash payments and the expenditure vouched whenever possible.

The petty-cash clerk must not be allowed to receive money for sundry cash sales. This must go direct to the cashier, who will pay it into the Bank daily with his other receipts.

6. The cashier's and accountant's departments must be kept distinct, and the cashier must have no control over the ledgers. As a general rule, no person dealing with cash should make entries in any book but the Cash Book. The monthly statements sent to debtors must be prepared in, and be despatched from, the accountant's department. Creditors' statements must be checked by the accountant's staff, and passed on to the cashier after having been verified with the ledger accounts.

7. As goods are received they must be checked with the invoices as to the articles received, quantities, prices, extensions and additions, and the invoices signed as correct by the person responsible. The invoices should then be handed to the entering clerk for entry in the Purchases Book, after which they should be numbered and filed.

8. Invoices for goods sold should be prepared by one clerk and checked by two other persons if possible, particularly as to prices, extensions, and additions.

9. The stock must be carefully kept, and if it is large the purchases, after being checked with the invoices and orders, should be handed to a storekeeper with instructions not to issue any stock without vouchers signed by the authorized heads of departments. The storekeeper should keep a record of all stock received and issued in separate books for each department. The form and method of keeping this record are explained in the Chapter on Stock and Stores Accounts.

10. When the ledger is divided into sections, each must be made self-balancing. All postings must be made daily, books of original entry for alternate days being used if necessary. Postings should be checked by somebody other than the clerks who make the entries. The ledgers should be balanced regularly—say once a quarter.

11. When taking out the quarterly balances the ledger clerk should be instructed to schedule all accounts more than fourteen days overdue and submit them to the head of the counting house.

Strict observance of the foregoing rules should ensure regularity in the keeping of the accounts and render easy the preparation of the final Profit and Loss Account and Balance Sheet at the end of the trading period. The steps to be taken on closing the books are dealt with in detail in Chapter II of this Part.

Organizing the Staff

The internal office arrangements for writing up the books will depend very largely upon the size of the business and the numbers of the staff employed. It is only in small concerns that all the books of account can be kept by one clerk. In such cases he should have nothing to do with the handling of the cash or be allowed to deal with remittances received by post. The principal should attend to those matters himself, although the writing up of the Cash Book may be left to the clerk, who can obtain the necessary information from the counterfoils of the receipt books and cheque books.

When two clerks are engaged on the books, one of whom acts as cashier, he should not have charge of the ledgers or be allowed to make entries in them, but as far as possible should be given the work of keeping the subsidiary books. The other clerk should make the postings to the ledgers, prepare the monthly statements for customers, and be responsible for the accuracy of all accounts received from creditors, certifying them before they are paid.

In undertakings of considerable size, all the books of account are divided into sections; firstly, because of the impossibility of one bookkeeper keeping them all; and secondly, for convenience in handling them. The second reason operates in even moderately sized businesses in the case of the ledger, which has, of course, to contain all accounts, whether personal, real, or nominal, and, not being a chronological record, is not entered up page by page from day to day like the books of original entry. Those books can be used continuously until they are full, when new books can be commenced, but the opening of a new ledger, unless loose-leaf ledgers are used, involves the transfer of all "live" accounts from the old book. This means a large amount of work, and, to obviate the necessity of opening new ledgers frequently, the book is divided into sections, each of which, as already pointed out, is a volume of one complete book.

Division of the Ledger

The sections into which the ledger is divided are usually three in number, one of which, containing customers' accounts, and another containing creditors' accounts, are frequently further subdivided. The first section is known as the General or Impersonal Ledger, and contains the real and nominal accounts. Even this section sometimes has a subsection, called the private ledger, containing the proprietors' Capital and Drawing Accounts and the Profit and Loss Account. The second section is used to record the accounts of creditors of the business—persons who have supplied goods—and

is known as the Bought Ledger or Purchases Ledger. Where the accounts are long or numerous, the section is divided into Town and Country Ledgers, or into volumes containing the accounts of creditors whose names begin with certain letters of the alphabet, e.g. A–F, G–O, P–Z. The third section, or Sold Ledger, contains the accounts of persons to whom goods have been sold; and as these will be far more numerous, it is generally found necessary to have more than one volume to record the transactions with them. A similar plan to that above mentioned for the Bought Ledger is adopted, the sections of the alphabet being, of course, smaller in each volume.

The method of making entries in the various sections from the records in the books of original entry is the same as if one volume only were in use, care being exercised not to open more than one account for any firm or individual. The double entry of the purchases and sales will be made in the manner described above on pp. 113 and 114. The fact that the Purchases and Sales Accounts are in one section of the ledger and the Personal Accounts in another does not affect the entries, for the reason that the sections, as explained, are merely volumes of one book which contains the complete record.

Division of the Purchases and Sales Books

For convenience in posting the Purchases and Sales Books they are often divided into two parts, one being used to record transactions on Monday, Wednesday, and Friday, and the other on Tuesday, Thursday, and Saturday. By this means the posting to the ledger does not interfere with the work of entering the Purchases and Sales Books and can be carried out daily, which means a great gain in the efficiency and usefulness of the records. In the case of very large undertakings divided into departments, separate sets of Bought and Sold Ledgers are used for each, with corresponding subsidiary books. The methods devised to secure the correct balancing of a number of sections of the ledger are explained in Chapter II.

When all the accounts can be kept in one ledger, it is the practice to keep all accounts of the same nature together. The Capital Account is usually placed first, then the real and nominal accounts, and finally the personal accounts, the debtors being kept as far as possible distinct from the creditors.

When the size of the business is such that several bookkeepers are engaged on the accounts, they may usually be divided into three groups: (1) the cashiers, (2) the entering clerks, and (3) the ledger clerks. The cashiers should be restricted to work upon the Cash Book so far as the records are concerned. In addition, they will make out receipts, pay cash and remittances into the Bank, prepare cheques, and generally deal with the cash. As in the case of a business with a single bookkeeper, they must not be employed on the ledgers, the rule being not to give any opportunity to persons handling money of tampering with customers accounts. The entering clerks will be employed on making the entries in the subsidiary books and in checking the inward and outward invoices. They may also be given the work of checking the ledger postings, although in very large businesses this would be done by a special staff detailed to carry out the internal audit.

The ledger clerks' work would consist of posting the Cash Book and the subsidiary books relating to purchases, sales, returns, bills, &c., preparing monthly statements for rendering accounts to customers, and checking statements received from creditors. No ledger clerk should be allowed to make entries in any ledgers except those under his immediate charge.

The checking of the entries in the books should be so arranged that it is performed, whenever possible, by two persons not concerned in the making of the original entries.

ACCOUNT-KEEPING WITHOUT BOOKS

This heading is not intended to indicate that a trader may, or should, dispense with records of his business transactions. These must always exist; but systems have in recent years been devised in which the records are kept by the filing or use of original documents in place of the books of original entry, and cards have been introduced to take the place of ledgers. This is more with the object of saving time than with the idea of superseding the books, the use of which has already been explained.

In some of the ways in which the system is applied, it is by no means new. It is an old and not uncommon practice to fold inward invoices and paste them into guard books, merely extending the totals into money columns on the right-hand side of the page. This saves a considerable amount of time in copying out the particulars of each invoice into a Purchases Book, and reduces the risk of error. The postings to the creditors' ledger accounts can be made from the invoices

themselves, while the total of the purchases is readily obtained by a cast of the extended totals. Another method familiar to all customers of large stores or drapery establishments is the practice of the counter assistants to enter on a perforated invoice form particulars of all sales for cash over the counter, and to enter on a form at the end of the counter book, in numerical order, the amount of each sale effected. At the same time a carbon copy of the invoice is retained, the original being handed to the customer. In these concerns there is not much saving of time effected in the keeping of the books, as it is not the practice to enter details of cash sales in any event, but the total of the assistants' summaries should agree with, and form a useful check upon, the takings of the cashiers.

Carbon Duplicate System

This method is extended in many undertakings to credit sales also, the total of each salesman being entered in a Sales Book daily, and the duplicate invoices filed in numerical order after the customers' accounts have been debited direct from the invoices. So long as the invoices are numbered consecutively in each salesman's book there should be no risk of loss of a copy invoice, as the fact that a certain number was missing would be quickly detected by the filing clerk. Every invoice should show the folio to which it has been posted, and none should be filed without the posting folio being marked upon them. This precaution strictly observed should ensure that all goods sold have been charged to the customers. In some businesses the duplicate invoices, instead of being torn out of the book and filed, remain in the book in the same manner as the sheets of a carbon letter book. This avoids the risk of loss, but does not quite come within the terms of the above heading, although the book is not a book of account in the ordinary meaning of the term. To summarize, the advantages of this system are the saving of time in copying the invoices into a Sales Book, the reduction of the risk of error to a minimum, and the certainty of having all goods sold charged out to customers; the disadvantages are the slight risk of loss of an invoice, and the fact that reference to an old transaction is not so convenient as when the sales are entered in an ordinary Sales Book.

The carbon duplicate method has been applied to the receipt of cash and the duplicate receipts used, with the aid of a cash column on the counterfoil, as subsidiary Cash Received Books. This system has not, however, found ready acceptance, and the general opinion is that where small receipts are numerous it is more convenient to record them in the usual manner in bound books subsidiary to the general cash book.

Card Ledgers

The branch of account-keeping in which books have been largely superseded is that relating to ledger accounts. The principal innovation here is the employment of cards kept in a drawer or tray. This method is in use chiefly in connection with the accounts of customers for goods sold, i.e. the most numerous class of accounts, although it is also used to take the place of a Bought Ledger. The cards are ruled in the form of an ordinary ledger account, and are kept in alphabetical order. They are, of course, loose and removable for the purpose of making entries, and while in the drawer are retained in position by means of a rod passed through a slot in the lower part of the card. Entries are made on them in the same way as on a ledger account in a bound book, so that they do not lead to the saving of time in the actual making of the entries. The advantages claimed for the system are that it obviates the necessity of continually opening new ledgers, as when cards are full they can be removed from the current drawer to one containing closed accounts; the cards index themselves and are always in the same relative position; there is no carrying forward an account to another folio when the space set aside for it is full. The necessity for the latter operation is a serious drawback in an ordinary ledger when an account is found to require much more space than has been allotted to it when the ledger was opened. The work of extracting balances periodically is greatly facilitated, as live accounts only are retained in the current drawer, all closed accounts being removed to a file in the same way as the full cards of current accounts.

Loose-leaf Ledgers

This card system of ledger-keeping is similar in principle to what are known as loose-leaf or perpetual ledgers, which are regarded by some accountants as not being really books in the strict sense of the word, but as files of accounts. Instead of the accounts being kept on cards they are on pages of ordinary size, which are fastened to a cover and made up into the appearance of a book, except that the back contains a locking arrangement to retain the leaves in position. The advantages are practically the same as those claimed for the card system, with the addition that, the leaves being larger than the cards, special rulings which may be required in certain businesses are possible.

The drawbacks of both card and loose-leaf ledgers are the risk of loss of a card or leaf and the substitution of a falsified card. The latter risk can be reduced to a minimum by all spare cards or leaves being kept by the manager, and only handed out to the ledger clerks on production of completed cards. The names of the customers for whose accounts the new cards are provided should be written on each card before being given to the ledger clerk. Another safeguard is to have the cards numbered consecutively, and to keep them in numerical instead of alphabetical order. This involves the use of a separate index, and the retention of dead accounts and full cards amongst those in current use.

It is a somewhat common practice for shopkeepers and others in a small way of business not to keep ledger accounts for those firms from whom they buy goods on credit—in other words, no Bought Ledger. This is account-keeping—of a kind—without books, but obviously has serious disadvantages. The general rule when this state of things exists is to keep all unpaid invoices on a current file until a monthly statement is received, and then to check off the items carefully, paying the agreed amount. The payment is posted from the credit of the Cash Book to the debit of a Purchases Account in the ledger. This practice is not to be recommended, as there is no complete record in the books of the dealings with the creditors, nor can the state of any account be quickly or accurately ascertained. There is always the risk of an invoice being mislaid, or being placed on the paid instead of the unpaid accounts file.

THE LAW AS TO KEEPING ACCOUNTS

It was mentioned in an earlier portion of this chapter that the laws of some countries, notably France, provide for the record in the journal of all a trader's transactions. No similar provision exists in the laws of this country, and there is no legal obligation on individuals to keep books. It is, therefore, quite optional for any person or firm to carry on business without keeping books or any other records of their trading. The result would, of course, be disastrous in any but the smallest shops, and no credit undertaking could dispense with the use of books of account.

But although there is no legal obligation on individuals to keep accounts, there are provisions in certain Acts of Parliament which indicate that the Legislature assumes that accounts will be kept as a matter of course. Thus, section 8 of the Bankruptcy Act, 1890, provides that if, on the application of a bankrupt for his discharge, the Court finds that he has omitted to keep such books of account as are usual and proper in the business carried on by him, and as sufficiently disclose his business transactions and financial position, within the three years immediately preceding his bankruptcy, his discharge must be suspended for at least two years (see Part III, Chapter XI). This is clearly authority for saying that the law, while not compelling a trader to keep books, penalizes him for not doing so if his affairs come within the jurisdiction of the Bankruptcy officials as a result of his failure in business. It is, further, a clear intimation that every trader is expected to keep books of account, and to keep them in such a manner as to furnish information which is universally regarded by business men as essential to the efficient and successful conduct of a business.

There are other Acts of Parliament which indicate the assumption by the Legislature that accounts will be kept by business men. In particular may be mentioned the Partnership Act, 1890, which provides that the books of a partnership shall be kept at the place of business, and that every partner shall have access to them. The Act also deals to an extent with the principles to be observed in keeping the accounts, in the absence of any agreement between the partners, and it regulates the manner of taking accounts in the event of dissolution. It further gives every partner the right to have true accounts rendered by his other partners of all things affecting the partnership. (See also Part III, Chapter III.)

Companies' Books

In the case of companies incorporated by special Acts of Parliament for certain purposes, and ordinary joint-stock companies incorporated under the Companies Acts, Parliament has gone further in providing for the keeping of accounts than it has in relation to the individual. Thus, the Regulation of Railways Act, 1868, makes it obligatory for railway companies in the United Kingdom to keep proper accounts; and a special form of account is framed for them to use, in order to furnish the information to the proprietors and the public that Parliament considered should be given. The system then laid down is known as the Double Account system, and is fully explained in another Chapter of this Part. It has since been extended to apply to Gas, Water, Electric Lighting, and

other undertakings of a more or less permanent nature rendering what may be described as public services.

The Companies (Consolidation) Act, 1908, provides for the appointment of an auditor by every company incorporated under that Act, although it is silent as to the actual keeping of the accounts that are to be audited. The model set of regulations for the management of companies, known as Table A, which applies to all limited companies not having regulations of their own, does, however, contain directions for the keeping of accounts. The directors of the company are required to cause true accounts to be kept of the assets and liabilities of the company, of the moneys received and expended by the company, and the matters in respect of which such receipts and expenditure take place. At least once a year the directors are required to have made out a Profit and Loss Account and Balance Sheet, which are to be laid before a general meeting of shareholders. A copy of the Balance Sheet and a report of the directors on the company's affairs must be sent to every shareholder of a public company before the meeting. The company's books of account are to be kept at the registered office of the company and be open at all times to the inspection of the directors, who may, if they think fit, make regulations for their inspection by the shareholders. (See also Part III, Chapter IV.)

The reason for the provision of regulations for the keeping of accounts of public companies is that the capital of those concerns has been subscribed by the public, and is administered by directors on their behalf. It is necessary, therefore, that the actual proprietors, the public, should know how their property has been dealt with by the officers of the companies. To ensure that this shall be done, Parliament has made the provisions mentioned above for the protection of shareholders.

There are certain persons who, in their character as trustees, are required by law to render accounts to the beneficiaries and others on whose behalf they are appointed. These include executors and administrators, trustees under wills, bankruptcies, and deeds of arrangements, liquidators of companies, receivers for debenture holders, and others in similar positions. All these persons are required to account because of their trustee capacity. They do not, of course, have to account in connection with their personal affairs.

CHAPTER II

METHODS OF BALANCING

The Trial Balance—Adjustments on Closing the Books—Depreciation—Self-balancing Ledgers

THE TRIAL BALANCE

It has been already pointed out that as every transaction is, in modern bookkeeping, fully recorded by the system of double entry, the totals of the two sides of a ledger must agree if the record has been correctly kept, since every entry on the debtor side of the accounts has its corresponding entry on the credit side. Accuracy is the first essential of all accounting, and tests of the correctness of the accounts are applied more or less frequently, according to the size of a business. The test is made by compiling what is called a Trial Balance, which, as its name implies, is an attempt to ascertain whether the books balance, i.e. whether there is an equal amount on each side. This is done by making a list of all open ledger accounts, and entering in one of two columns the difference or balance on each account. As already explained, the extraction of the balances is as effective as taking the total postings. The form of the Trial Balance (which is not entered in the books, but is prepared on sheets of paper) is as follows.

TRIAL BALANCE

Name of Account.	Ledger Folio.	*Dr.* Balance.			*Cr.* Balance.		
		£	*s.*	*d.*	£	*s.*	*d.*
Cash	C.B. 75	56	8	10			
Discount	"	14	5	1			
Bank	"	396	4	3			
Petty Cash	51	10	0	0			
Stock	20	645	0	0			
Purchases	30	2799	11	4			
Sales	40				4691	3	2
Returns Inward	50	29	8	0			
Returns Outward	55				32	6	9
Sundry Trade Expenses	60	179	10	0			
Salaries	65	250	0	0			
Wages	75	416	9	6			
Rent, Rates, and Taxes	85	205	0	0			
Bad Debts	90	30	4	11			
Capital	250				2000	0	0
Drawings	260	300	0	0			
W. Smith	28	45	9	2			
A. Brown	30	36	8	7			
C. Jones	31	21	2	6			
F. Robinson	111				72	6	6
S. Black	119				95	10	0
Sundry other Debtors (set out in detail)	—	875	16	3			
Sundry other Creditors (set out in detail) ...	—				819	12	0
Premises, Fixtures, and Furniture	210	1400	0	0			
		7710	18	5	7710	18	5

Care must be taken to enter the balance in the appropriate column, debit or credit as the case may be. Real and nominal accounts will present little room for error in this respect, as the nature of each of those accounts, with few exceptions, is such that the balance will always fall on the same side year after year. Personal accounts may, of course, have either debit or credit balances, and where debtors and creditors are contained in the same ledger there is need for extra care in entering the balances in the Trial Balance.

The extraction of the Trial Balance, besides being a test of the accuracy of the records, is a preliminary step to the preparation of the Trading and Profit and Loss Account and the Balance Sheet. If the totals of the debit and credit columns agree, it may be assumed—although it is not certain—that the accounts are correct, and the work on the final accounts may proceed. But if the totals do not agree, it is useless to go further until the error has been traced and rectified. The difference between the totals may be sixpence only, but it does not necessarily mean that there is one error of sixpence on a certain but unknown account. It may be that £500 has been omitted from one side and £499, 19*s.* 6*d.* from the other; or it may be the net difference of several errors. Whatever the error may be, it must be traced. It may be in the Trial Balance itself, or in the ledger, or in one or more of the books of original entry.

Tracing Errors

Let it be assumed that a Trial Balance has been extracted from the books, and that the totals of the two columns do not agree. The steps to be taken to trace the error thus disclosed would begin with the Trial Balance itself. The two columns must be recast to ascertain whether the error is in the Trial Balance and not in the books. If this step proves ineffectual, it will be necessary to check the balances of the ledger accounts by going through the ledger and ascertaining that the balances have been correctly extracted and entered in the proper columns of the Trial Balance. To do this, both sides of every account must be recast and the differences checked, care being taken to scrutinize the entries for the purpose of ensuring that one figure has not been mistaken for another. Threes, fives, and eights are sometimes mistaken for one another. A long tail to a 7 or 9 may be taken for 1 in the line below. Figures written too close to the lines dividing the money columns may be taken as being in the £ column instead of in the shillings column, or *vice versa*. All or any of these things would result in a difference in the Trial Balance, for the reason that, while the correct amount would be taken out on one side of the ledger, an incorrect amount would be extracted on the other side, owing to carelessness in one or more of the matters mentioned.

While checking the extraction of the balances, watch should be kept for an item of the amount of the difference or of half the amount. It may be that an amount has been posted to one side of the ledger and not to the other. This would cause a difference of that amount in the Trial Balance, and if the ledger accounts are numerous it might save time to examine the books of original entry for an item of the required amount. If an item has been posted twice to the same side of the ledger instead of once on each side, the result will be an error of twice the amount of the item, and again the subsidiary books might furnish the clue to the location of the error. If these steps and the check on the extraction of the balances do not result in finding where the error has occurred, it will probably be necessary to call over the postings of the books of first entry. This is a laborious process, and resort should not be had to it until all other measures have failed. Such a task would be a practical impossibility in a business where many ledgers are kept, but the necessity is obviated in such a case by a device for balancing each ledger separately, which is explained on p. 133. The trouble caused by an error in the Trial Balance is so considerable that too much stress cannot be laid on the advisability of having the original work called over daily, if possible by somebody other than the clerk who made the postings. Another safeguard against error which is possible in a large business is to have clerks posting sales different from those posting purchases. There is then less likelihood of an item being posted to the wrong side of a personal account, since the clerks will be accustomed to making certain entries on only one side of the accounts.

Compensating Errors

The Trial Balance discloses only those errors which arise from unequal amounts having been entered on the two sides of the ledger. It does not show any errors in the keeping of the accounts which do not cause a difference between the debit and credit sides. Thus, what are called compensating errors do not appear from the Trial Balance; that is, if an error of the same amount has been made in connection with two distinct transactions on different sides of the ledger, the two columns of the Trial Balance will agree. Similarly, if an incorrect amount has been entered in a book of original entry, it will be posted incorrectly to both sides of the ledger and will not affect their

agreement. Thus an amount entered on the debit side of the Cash Book as £57, 8*s.*, instead of £50, 7*s.* 8*d.*, would be posted to the credit of the sender as £57, 8*s.*, and no difference would arise. A purchase of goods for £162, 5*s.*, if entered in the Purchases Book as £162, 15*s.*, would be posted to the credit of the seller at the latter amount. It would also be included in the total purchases of the month at the same sum and be debited to the Purchases Account. A similar mistake might be made with a sale, and in neither case would the agreement of the two sides of the ledger be affected.

Discovery of Errors

It is the practice to assume that the books are correct if the totals of the Trial Balance agree. The discovery of errors such as those just mentioned is practically certain sooner or later, and the work of preparing the final Profit and Loss Account and Balance Sheet proceeds as soon as agreement is reached in the Trial Balance. The manner in which errors arising from incorrect entries in subsidiary books are brought to light depends upon the nature of each mistake. The discovery of an error in the Cash Book should be immediate. If the money had been received or paid in coin the cashier would not be able to balance his cash at the end of the day, and would identify the error on reference to the accounts received with remittances or to the receipts obtained from the payees. If the money were in the form of a cheque, he should discover his mistake on making out his paying-in slip for the banker or by reference to the Pass Book.

If a customer has been overcharged on a sale, he will notify the trader on receipt of the invoice, and a correcting entry should at once be made in the books. In the event of an undercharge the same thing should happen; but it is possible that the notification would not be so prompt, and might even not be forthcoming at all. In the latter event the error might never be discovered. The remedy lies in measures for prevention, not cure. Careful comparison of orders and invoices will do much to ensure accuracy in the Sales Book. In the case of errors in the entry of transactions in the Purchases Book, discovery will be made when the monthly statements of account are received from the merchants and manufacturers supplying the goods. These documents must always be carefully checked with the creditor's accounts in the ledger before being passed for payment, and, if this work is efficiently performed, discovery of any mistake will be speedy and certain. Errors in connection with the original entry of goods returned either inward or outward will be discovered in a similar manner to those relating to original sales and purchases.

Another class of error not disclosed by the Trial Balance is that in which a posting has been made from a book of original entry to the correct side of the ledger, but to a wrong account. H. Smith may have been credited instead of W. Smith, or F. Brown debited instead of S. Brown. In either case the discovery would be brought about by the next monthly account rendered on either side. Those accounts are prepared from the ledger, and the person under-credited or over-debited would not fail to make the trader aware of the mistake, even if the person who had been benefited by the error did not do so. The discovery of what have been described as compensating errors will depend, as in the case of those dealt with above, on their nature. If they are in connection with purchases or sales, the means will be the same as in the case of incorrect original entries. If, however, there are errors of the same amount on different sides of two nominal accounts, it is quite possible that they will never be discovered, and the safeguard against mistakes on those accounts is to have an effectual check on the original entry. Exceptional care should be taken to guard against errors on nominal accounts, as they directly affect profits.

ADJUSTMENTS ON CLOSING THE BOOKS

After agreement of the Trial Balance, the work of preparing the Profit and Loss Account and Balance Sheet may proceed. The first step is to ascertain that all liabilities and charges against the business have been brought into the books. This will already have been done with regard to the liabilities for the purchase of goods, but there are other charges which are not entered in the books until they are paid. These liabilities or charges are chiefly of the nature of working expenses accruing from day to day, such as wages, rent, rates, lighting, &c. The general practice with regard to such items is to pay them shortly after they fall due, and to post the payment to the debit of the appropriate nominal account from the Cash Book. It is not usual, when a demand for rates or rent is received, to debit the Rent, Rates, and Taxes Account with the amount, and credit the Local Authority or the landlord, as the case may be. Still less is it the practice to debit the Wages Account and credit the workmen with the amounts earned day by day. But in a large manufacturing

concern employing a considerable number of hands it is necessary, at the end of a financial year, to take into consideration the liability of the business for wages accrued due to workmen for part of a week, but not paid before the end of the year. The degree of importance of this step depends upon the size of the business. In a small concern it is not a serious matter, although, if absolute accuracy is to be obtained, it must be taken into account. In large undertakings, however, it becomes imperative to deal with this and similar matters, or a misleading result of the year's trading will be shown.

Outstanding Wages

It is not an unusual thing for the weekly wages bill of a large manufacturer or shipbuilder to amount to something between £1000 and £10,000 a week. Workmen's wages are, as a rule, made up to Thursday night and paid on Friday or Saturday. If the financial year to, say, 31 March ends on a Wednesday, there will be four or five days' wages accrued due which have not been paid. This may amount to £5000, or even more; but unless special steps are taken to bring the expenses on the one hand, and the liabilities on the other, into the books, they will not be included in the Profit and Loss Account and Balance Sheet when those documents are prepared, because they will not have been paid within the financial year, and therefore will not have been entered in the accounts. There would not, in the ordinary course, be any entry in the books relating to the uncompleted week, as the usual method is to enter the payment of wages on the credit side of the Cash Book when paid, from whence it is posted to the debit of the Wages Account. In order to bring the accounts into accord with the facts, an entry is made on the Wages Account debiting it with the amount accrued due, which is carried forward on the credit side of the account for the following year. This has the effect of making each year bear its fair share of the charge for wages, as will be seen from the specimen account below, and also records the fact that there is a liability on the part of the business to the workmen for wages earned but unpaid at the end of the year.

WAGES ACCOUNT

1911.			£	s.	d.	1912.			£	s.	d.
Apr.	1 to 1912. Mar. 26	To Cash (being weekly postings from the Cash Book)	350,000	0	0	Mar.	31	By Transfer to Trading and Profit and Loss Account	355,000	0	0
"	31	" Balance accrued due and unpaid, carried forward	5,000	0	0						
			355,000	0	0				355,000	0	0
1912.						1912.					
Apr.	2	To Cash (being amount paid for the full week)	6,800	0	0	Apr.	1	By Balance brought down	5,000	0	0

This account makes it clear that the year to 31 March, 1912, has been charged with all the wages earned to the end of the year, and that by means of the credit carried forward the following year bears only its fair proportion of the week's wages paid on 2 April. The same method is adopted in the case of Rent, Rates, and Taxes, and other charges of a similar nature which may have accrued due but which have not been paid.

Payments in Advance

Adjustments of a similar kind, but on the opposite side of the books, must also be made in respect of any expenditure during a particular year, if the following year will receive any benefit or relief as the result of the payment. In other words, if payments have been made in advance for insurance, rates, or other expenses, a proportion representing the period for which payment has been made in advance must be deducted from the charge made against the current year, and carried forward as a charge against the next year. The specimen on p. 131 of a Rates and Taxes Account will illustrate the method adopted, the financial year ending on 31 March. The balance brought down to the debit of the account is included on the assets side of the Balance Sheet under the head of "Payments in Advance" or a similar description. The item is sometimes of considerable magnitude in the case of insurance under the Employers' Liability and Workmen's Compensation Acts, particularly if a payment has been made by an employer for a full year in advance shortly before the close of his financial year.

RATES AND TAXES ACCOUNT

1911.			£	s.	d.	1912.			£	s.	d.
Apr.	1	To Balance brought down.....	156	8	4	Mar.	31	By transfer to Profit and Loss Account, being Rates apportioned for the year to this date.....	679	0	0
Aug.	19	" Cash—Borough Rates for six months, to 31 Dec., 1911.....	351	6	8			" Proportion of Rates paid in advance c/f.....	171	5	0
1912.											
Feb.	26	" Cash—Rates to 30 June, 1912.....	342	10	0						
			850	5	0				850	5	0
1912.											
Apr.	1	To Balance brought down.....	171	5	0						

Reserve for Bad Debts

Another matter which has to be taken into consideration when balancing the books, is the necessity for making reserves for anticipated losses or expenses in relation to the transactions of the year just closing. Perhaps the reserve of this kind most frequently made is that in respect of doubtful debts. This must not be confused with the actual loss from bad debts which have become known during the year. The losses in respect of those debts have been written off to a "Bad Debts Account" as they accrued during the year, and the balance of that account will be transferred to the debit of the Profit and Loss Account. The reserve which is referred to is that which is created on the closing of the books at the end of a trading period in respect of the debts then outstanding due to the business.

A trader knows from past experience that some of his debtors will fail to pay. He cannot say which of them, or he would write off the amount at once, but it is certain that a portion of his debts will not be received. He therefore provides each year for the anticipated loss under this head. The debts outstanding at the end of any particular year have arisen from sales to customers for which credit is taken in the Trading Account for that year. If, therefore, there is to be any loss on those debts through the inability or failure of the debtors to pay, the year which has the benefit of the sales should bear the anticipated loss. The ideal method for making the provision for the loss under this head is for somebody with a knowledge of the debtors' means to go through all the accounts, and make an allowance on any account where there is a doubt as to the stability of the debtor. This is generally impracticable, and the method usually adopted is to make an allowance, by way of a percentage on the debts, based upon the experience of the actual bad debts incurred in previous years. Five per cent is a very usual allowance to make.

This allowance is really a holding-up or reserving of the profits of a year to meet an expected loss in respect of that year, and the sum so reserved is debited to the Profit and Loss Account with the other expenses and losses of the business. The entries required in the books are a debit to the Profit and Loss Account, and a credit to the "Reserve for Doubtful Debts Account". It is not possible to write off the amount against any specific debtors, so a special account is credited with the amount reserved.

The reserve is carried forward in the books from the beginning to the end of the year. Any bad debts which become known during the year are debited to the Bad Debts Account in the usual way, and not to the Reserve Account. At the end of each year the amount of the reserve is reviewed in the light of the experience of the year and the amount of the debts then outstanding. If there is a larger amount then owing than at the end of the previous year, an addition must be made to the reserve; while if the debts are less than a year ago, a portion of the reserve may be credited to the Profit and Loss Account, or used to reduce the debit in respect of the ascertained bad debts for the year. The method employed may be illustrated by the following example:—

At the end of the financial year to 31 March, 1911, the debts outstanding amounted to £3000, and it was decided to reserve 5 per cent for Doubtful Debts.

At 31 March, 1912, the debts were £3500.

At 31 March, 1913, they were £2800.

It was decided to maintain a Reserve of 5 per cent on them in each of the years 1912 and 1913.

The following is a copy of the Reserve Account as it would appear in the books after giving effect to the above.

RESERVE FOR DOUBTFUL DEBTS

1913.			£	s.	d.	1911.			£	s.	d.
Mar.	31	To Profit and Loss A/c, being the amount at present standing to credit of Reserve in excess of 5 % on £2800, the amount of the Debtors at this date	35	0	0	Mar.	31	By Profit and Loss A/c, being 5 % on £3000, the amount of the Debtors at this date	150	0	0
		" Balance c/d	140	0	0	1912. Mar.	31	" Profit and Loss A/c, being the amount required to make up the existing Reserve to 5 % on £3500 ...	25	0	0
			175	0	0				175	0	0
						1913. Apr.	1	By Balance brought down, being 5 % on £2800	140	0	0

This balance being on the credit side of the ledger would in the ordinary course appear on the liabilities side of the Balance Sheet, but when reserves are made against specific assets it is the practice to deduct them from those assets, and to show the latter at their estimated true value. In the Balance Sheet to 31 March, 1913, the debtors would appear in the Balance Sheet as follows:—

Sundry Debtors as per books ...	£2800
Less Reserve for Doubtful Debts	140
	£2660

Reserves for Discounts

Similar reserves are sometimes made for discounts on both debtors' and creditors' balances. The amounts of the reserves depend, of course, on the terms agreed as to discount between the trader and his manufacturers on the one hand and his customers on the other. A reserve for discount on debtors' balances would require precisely similar entries to those shown above for the reserve for doubtful debts. A separate account would be required with an appropriate title. In the case of a reserve for discount to be allowed by creditors the entries are, of course, reversed, the Reserve Account being debited, and the Profit and Loss Account credited, while the amount of the reserve is deducted in the Balance Sheet from the amount shown by the books to be due to creditors.

DEPRECIATION

A further question for the trader to consider when making up his accounts for the year is that of depreciation. Gradual loss of value takes place in the case of the great majority of what are known as fixed assets, such as plant, machinery, buildings, leaseholds, wagons, furniture, &c. None of these things last for ever, and their value to a business is constantly diminishing, merely because in many cases they are getting older and are being used in the business. For instance, plant and machinery by constant use become worn out, and in time have to be entirely replaced. Again, a leasehold factory for which a lump sum may have been paid down, by way of premium on the granting of the lease, ceases to be of value to the occupier at the expiration of the lease by reason of its reversion to the superior landlord. A business man of ordinary prudence should take note of all his assets which by their nature decrease in value by effluxion of time, and take steps to provide in his accounts for the loss of value.

The general principle to be observed is that any asset of a wasting nature should be written down in the books to its realizable value by the time it becomes useless for the purposes of the business. This is usually done by estimating the "life" of the asset where it is not definitely known, and also the sum that will be received if the asset is sold at the end of the time. The difference between the realizable value and the cost as shown by the books, is then written off over the period during which it is anticipated the asset will be used in the business.

In some cases, such as a lease, there is no realizable value, and the total loss, i.e. the cost, has to be written off during the period.

The entries necessary to be made in the books are first an entry in the journal, debiting Depreciation Account and crediting the asset for the amount it has been decided to write off. This is posted to the ledger to the debit of an account called the Depreciation Account, opened to

record all depreciation, and to the credit of the account of the asset affected. The balance of the Depreciation Account is transferred to the debit of the Profit and Loss Account in the same way as the other losses and expenses of the business. The effect of the credit on the Asset Account is to reduce the balance on the debit side which represents the cost or book value of the particular property. In process of time the account will be written down either to the estimated realizable value of the asset or to nothing, if, as in the case of a lease, there is no value remaining.

The whole subject of the necessity for providing for depreciation and making reserves is dealt with fully in the Chapter on "Reserves, &c.", and further discussion of the subject may therefore be postponed, but the proprietor of a trading concern must not forget, when balancing his books, that matters such as those mentioned above have to be taken into consideration.

SELF-BALANCING LEDGERS

Mention has been made of the fact that when more than one ledger is kept in a particular business, means are provided for balancing each ledger separately. The capacity of one book for keeping the accounts of an undertaking is, of course, limited, and when the number of accounts has grown to such an extent that their inclusion in one ledger is an impossibility, one or more further ledgers have to be brought into use. In many cases the ledger is divided into sections from the beginning, the respective sections being used to record the accounts of a particular class of transaction.

The usual division of the ledger is into Bought, Sold, and General Ledgers. The Bought Ledger contains the accounts of persons and firms from whom the business buys its goods or raw materials —the creditors—the Sold Ledger records the dealings with the customers, or debtors, and the General Ledger contains the various real and nominal accounts, such as Stock, Premises, Plant and Machinery, Purchases, Sales, Trade Expenses, Wages, &c. In concerns of considerable size it is necessary to subdivide the Sold Ledger into either sections of the alphabet—A to F, G to O, P to Z —or according to the locality of the debtors. This is also necessary in some cases with the Bought Ledger.

It must be remembered that although divided into sections there is really only one ledger, the several sections being merely volumes of one great book which, by reason of its size, cannot be contained in one binding. This being the case, it would be necessary, but for the device about to be explained, to extract all the balances in each volume and amalgamate them in one Trial Balance, in order to ascertain whether the sides of the ledger agreed in amount. If bookkeepers were infallible machines this would not be a very great drawback, but having regard to the fact that a Trial Balance rarely agrees at the first attempt in a business of any magnitude, it has been found essential to adopt means to obviate the necessity of preparing such a Trial Balance. If a general Trial Balance, composed of the balances in a number of ledgers, did not agree, the labour involved in endeavouring to trace the error or errors might be enormous. All that would appear would be that an error existed, but there would be no clue to the whereabouts of the mistake. In order to trace it, it might be necessary to call over the posting of all the sections of the ledger. This would be a prohibitive task, owing to the time it would occupy, and many traders would prefer to carry forward a difference on the books rather than go to the expense and labour of tracing the amount. But that is an unsatisfactory position, as the books are known to be incorrect, and it might in some cases result in loss to the business. It would put a premium on carelessness on the part of the staff, and might indirectly lead to falsification, because of the knowledge that differences would not be thoroughly investigated.

Separate Balancing of each Ledger

With the object of ensuring accuracy and localizing errors in the books, a scheme has been devised for use in undertakings where the ledgers are numerous. It is applicable to any business where more than one ledger is employed, but its value is greatest where there are several. The aim of the system is to effect the balancing of each ledger in itself. This is obviously an immense gain, and while the extra work involved might deter a trader with two or three ledgers from adopting the device, the compensating advantages are so great that its use is to be recommended in all cases. In large undertakings the application of the principle in some form or other is practically indispensable.

When the ledger is divided into the usual sections of Bought, Sold, and General Ledgers (the last-named being sometimes further divided into Impersonal or Nominal and Private Ledgers), the accounts contained in the Bought and Sold

Ledgers are as a rule personal accounts only of debtors and creditors, although sometimes Bills Payable and Bills Receivable Accounts are kept in the respective ledgers. The personal accounts in the Bought Ledger will, save in exceptional circumstances, be those of creditors, i.e. the balances will all be on the credit side. In the Sold Ledger the converse will be the case, and the balances will fall on the debtor side. If these ledgers are to balance in themselves it will be necessary to have an account to counterbalance the total of the personal balances, and it is the creation of this account that has now to be explained.

As Sold Ledgers are more numerous than any other class of ledger, and the entries in them are more numerous than in any others, the necessity for separate agreement is more urgent than in the case of other ledgers. The entries made on the personal accounts in the Sold Ledgers are first a debit to the customers in respect of goods sold, and then a credit of the cash received in payment. In addition there may be credit entries for discount returns or allowances and bills receivable. There may also be debits for dishonoured cheques or bills. The particulars from which these entries are made are obtained from the Cash, Sales, Returns, and Bills Books and the Journal, from which the postings will have been made in the ordinary manner. Thus the Sales Book will have been posted item by item to the debit of the customers, and the total to the credit of the Sales Account in the General Ledger. But although this will have resulted in double entry in the ledger taken as a whole, all the entries in the Sold Ledgers will be on one side, viz. the debtor side.

Balancing the Sold Ledgers

The first step to make the Sold Ledgers balance separately in themselves is to ascertain the total of the sales posted to each. To do this it is necessary either to have a separate Sales Book for each ledger or to have analysis columns in the Sales Book in which are extended the amounts posted to the respective ledgers. At the end of each month the total of each book or analysis column is posted to the credit of an account opened in its relative ledger. This will have the effect of completing double entry of the sales in each Sold Ledger, since the amounts posted separately to the customers have been posted in total to the credit of the special account mentioned. This does not affect the ordinary posting of the total sales, which must be made to the credit of the Sales Account in the Impersonal, Nominal, or General Ledger. The postings to the special accounts in the several Sold Ledgers are in addition to the ordinary postings. These special accounts, raised to enable each ledger to be balanced separately, are termed "Adjustment Accounts". As they are in addition to the ordinary double entry of the transactions, they would, if included in a Trial Balance of all the ledgers, cause a difference. Corresponding accounts are therefore as a rule opened in the Impersonal or General Ledger, the entries on which are made on the opposite sides to those in the original ledgers. Thus the sales posted to the credit of the Adjustment Accounts in the Sold Ledgers are entered on the debit side of the Adjustment Account in the Impersonal or General Ledger. For purposes of identification the Adjustment Account in each Sold Ledger is called the General Ledger Adjustment Account, while those in the General Ledger are called A to F Sold Ledger Adjustment Account, G to O Sold Ledger Adjustment Account, &c.

The cash received from customers and the discount allowed to them has to be treated in a similar way. Analysis columns are ruled on the debit side of the Cash Book, one for each Sold Ledger, to which are extended (in one sum) the cash received from each debtor, and the discount, if any, allowed to him. These are posted to the customers' credit in the usual way, and the total of each analysis column in the Cash Book is posted at the end of the month to the debit side of the General Ledger Adjustment Account in each Sold Ledger. This again means entering in total on the Adjustment Account in the Sold Ledgers the same amount as has been entered on the opposite side of the customers' personal accounts, and the result is to effect double entry in the Sold Ledger. Care must be taken to enter the analysis totals on the Adjustment Accounts in the General Ledger, so as to preserve the balancing of the books as a whole.

By means of the steps described above, the two principal classes of items on customers' accounts, viz. sales and cash, receive complete double entry in the Sold Ledgers, and, so far as they are concerned, each Sold Ledger will balance in itself if the work has been accurately performed. As mentioned above, however, there are other entries usually made on customers' accounts, such as bills receivable, bad debts, returns and allowances on one side and dishonoured cheques and bills on the other, for which provision must be made in order to obtain double entry in the Sold Ledgers. So far as Bills, Returns, and Allowances are concerned, the necessary particulars are obtained by analysis columns being kept in the Bills and Returns Books. The bills and returns received from debtors and the allowances made to them are posted to their credit in the usual way, and the totals of the

analysis columns are posted to the debit of the Adjustment Accounts in the respective Sold Ledgers, thus preserving their double entry. To obtain particulars of dishonoured bills and cheques which have been posted to the debit of the customers from the Cash Book or Journal, it will be necessary to go carefully through the Cash Book and make lists for each ledger of all cheques and bills returned from customers in the respective ledgers. The totals will then be posted to the credit of the several Adjustment Accounts in the Sold Ledgers in order to complete the double entry in those ledgers.

When dissecting the Journal for any dishonoured bills, particulars should also be extracted of all bad debts written off, and any other items, such as transfers, which affect the Sold Ledgers. The totals of the items relating to each Sold Ledger should be posted to the respective Adjustment Accounts on the opposite side to that on which the separate items have been entered on the customers' accounts.

When all these steps have been taken, the Adjustment Account in a Sold Ledger would appear in the following form:—

GENERAL LEDGER ADJUSTMENT ACCOUNT
(As appearing in Sold Ledger A to F)

1912.			£	s.	d.	1912.			£	s.	d.
Dec.	31	To Cash received from and discount allowed to Customers in this Ledger....	23,845	9	7	July	1	By Total of Balances on Debtors' Accounts in this Ledger as per Schedule.....	5,627	8	4
		" Bills received from Customers in this Ledger...	2,817	10	0	Dec.	31	" Sales to date debited to Customers in this Ledger	28,419	3	6
		" Goods returned from Customers in this Ledger ...	211	19	0			" Dishonoured Bills and Cheques as per dissection of Cash Book.....	128	5	0
		" Sundry allowances as per Allowance Book.....	85	4	6						
		" Bad Debts written off.....	121	8	2						
		" Balance carried down, being total of Debtors' Balances in this Ledger at 31 Dec., 1912.....	7,093	5	7						
			34,174	16	10				34,174	16	10
						1913.					
						Jan.	1	By Balance b/d.....	7,093	5	7

There will be a similar Adjustment Account in the General Ledger for each of the Sold Ledgers, in order, as stated above, to preserve the balancing of the books as a whole. The various items will, of course, be on the opposite sides, but in other respects the accounts will correspond with the Adjustment Accounts in the Sold Ledgers.

Balancing the Bought Ledgers

The method described above in connection with Sold Ledgers may be adopted for use in the case of the Bought Ledger, of which there is frequently only one. When that is the case, no extra books or special rulings are required, except an extra column on the credit side of the Cash Book, in which is entered every payment made to a creditor whose account is kept in the Bought Ledger. The Purchases Book is posted in the usual manner to the credit of individuals and the debit of the Purchases Account in the General Ledger. In addition, the monthly or quarterly total of the purchases is posted to the debit of a General Ledger Adjustment Account in the Bought Ledger, and to the credit of a Bought Ledger Adjustment Account in the General Ledger. This has the effect of giving double entry of the purchases in the Bought Ledger, while the adjusting entry made to bring about this result receives its compensating record in the General Ledger.

The cash paid to the creditors is posted to their debit in the ordinary course from the Cash Book, and as all the payments plus discounts are extended into the special column mentioned above, the total is easily ascertained and posted to the credit side of the General Ledger Adjustment Account in the Bought Ledger. This again provides double entry in the Bought Ledger. The total cash and discount is also entered on the debit side of the Bought Ledger Adjustment Account in the General Ledger, to ensure the general balancing.

All other items posted to the personal accounts of the creditors in the Bought Ledger, such as Bills Payable, Returns and Allowances, must be entered in total on the Adjustment Account in

the Bought Ledger on the opposite side to that on which they were entered in detail on the personal accounts. The Adjustment Account in the Bought Ledger will then appear as follows:—

GENERAL LEDGER ADJUSTMENT ACCOUNT
(As appearing in Bought Ledger)

1912.			£	s.	d.	1912.			£	s.	d.
July	1	To Total of Balances on Creditors' Accounts in this Ledger	4,862	17	9	Dec.	31	By Cash and Discount debited to Personal Accounts for six months	18,614	5	8
Dec.	31	" Purchases for six months to date credited to Personal Accounts in this Ledger	19,743	18	11			" Bills Payable given for six months	842	0	0
								" Returns to Creditors in this Ledger	156	8	5
								" Allowances by Creditors in this Ledger	28	3	6
								" Balance carried down agreeing with total of Personal Balances	4,965	19	1
			24,606	16	8				24,606	16	8
1913.											
Jan.	1	To Balance b/d	4,965	19	1						

It is well to prepare the Adjustment Accounts in draft before entering them in the books, in case there should be a difference. In fact, in some undertakings it is the practice to keep the Adjustment Accounts outside the books altogether, merely entering them on loose sheets. If it appears from the draft account that the balance does not agree with the total of the balances on the personal accounts, it is evident that there is an error. In the absence of Adjustment Accounts this would have appeared in a general Trial Balance of all the ledgers of the business, and it would not have been possible to say in which ledger the mistake was located. But the Adjustment Accounts point out at once in which book search has to be made to find the difference. The Adjustment Account would itself first be scrutinized, and if this did not result in discovery, the steps set out in an earlier portion of this chapter in relation to an ordinary Trial Balance would then be pursued.

In conclusion, it cannot be too strongly urged that the benefits to be derived from the use of a system of self-balancing ledgers is so great in a business where many ledgers are in use, that a trader is flying in the face of his own interests who does not adopt the principle.

CHAPTER III

CAPITAL AND REVENUE

Importance of Distinction—Allocation of Expenditure—Fixed and Floating Assets—What are Profits?

IMPORTANCE OF DISTINCTION

Economically speaking, Capital is wealth or property set aside, or conserved, to be used for the production of more wealth. The wealth so produced is commercially known as Revenue or Profit.

Employment of Capital

When Capital is employed in a business the object is to earn profit, and it is of the first importance that the proprietor of the Capital should ascertain from time to time to what extent this object is being achieved. It often happens that Capital, in the process of earning profit, becomes itself exhausted. Its employment, under such circumstances, often results merely in a conversion of the Capital from one form of property into another. Profit may have accrued in the process, that is to say, the property representing the Capital at the end may be more valuable than the property representing the Capital at the beginning, or it may result in a shrinkage in the value, in which case there will have been a loss.

Now, nearly all property employed commercially as Capital is subject, in a greater or lesser degree, to a diminution in value, either directly resulting from, or occurring in the course of, such employment; and it is the recognition of this fact, and the necessity of making provision for Capital lost in this manner, which, more than anything else, make it essential that proper distinction between Capital and Revenue should be maintained in accounts.

The bare knowledge that the employment of a certain amount of Capital, during a given period, has resulted in an ascertained profit or loss is not sufficient. The owner of the Capital should know exactly how such profit or loss has arisen, and here again the necessity for distinguishing between Capital and Revenue is apparent. If the assets of a business are valued on 1 January, and again on 31 December, and it is found on the latter date that there is an increase of £500, that amount is, economically speaking, profit, provided, of course, that no additions from outside the business have been made to Capital in the meantime. But you cannot tell whether such profit has arisen from the ordinary business of the concern, or from an appreciation of one or more of the Capital items. As a fact, the actual business might have been carried on at a much larger profit than the £500 shown; for example, suppose some plant had been purchased out of Revenue on 1 November for £500, and it was considered advisable to value this on 31 December, at no more than the price it would fetch as secondhand machinery, say 50 per cent of the cost price. Here you would have what may, for the purpose of the illustration, be regarded as a loss on Capital Account of £250, coming out of revenue; for it would not be fair to charge the whole of this depreciation against the Revenue receipts of so short a period, and certainly a wrong idea of the earning capacity of the business would be conveyed by any system of accounts which did not clearly disclose what had been done, and this could only be accomplished by treating expenditure on Capital and Revenue account separately.

Results of Non-observance

There is no doubt that failure to appreciate and observe the distinction between Capital and Revenue may result in financial disaster to private investor, trader, and limited company alike: to the private investor, because he may find himself in reduced circumstances through having spent as income what, in fact, was a gradual return of Capital; to the trader, because it may bring him to the bankruptcy court, or, at any rate, so impoverish his resources as to make it impossible for him to continue in business; and to the limited company, because, apart from the illegality of improperly paying dividends which have not actually been earned, insolvency and compulsory liquidation may ensue.

Let us consider the matter as it affects each of these. First, take the case of a private individual of independent means, whose income is derived from an investment in Government bonds. We will suppose that he possesses such to the par value of £15,000, bearing interest at the rate of 4 per cent per annum. His yearly income will thus amount to £600. We will assume, further, that the bonds are redeemable, say twenty years hence, at par. Being assured beyond reasonable doubt of the ultimate recovery of his Capital, our investor is justified in regarding as true income the £600 received by him each year. But he is not satisfied with this return on his capital, and so disposes of the bonds at their par value, purchasing, with the proceeds, shares of the nominal value of £1 each in a gold-mining company. The market price of these shares is £3 each, so that he is able to purchase 5000 of them. The company pays dividends at the rate of 30 per cent per annum, of course on the nominal value, which, calculated on the price he pays, yields 10 per cent on his Capital. His annual income is now, therefore, £1500. The life of the mine is estimated at ten years, but this factor he disregards. Now even if the company makes provision for the eventual working out of the mine, by the provision of a sinking fund, which it is not legally bound to do, our investor cannot hope for a return on account of Capital of more than £5000 (the nominal value of his shares) at the end of the ten years. Every dividend that he receives, therefore, is in part a return of his Capital; and should he be so foolish as to regard it otherwise, and spend the whole as he was entitled to do in the case of the interest from the Government bonds, he will find, when in due course the mine is exhausted and the dividends cease, that he has been spending not only interest but principal as well.

Now for the trader. Let us suppose him starting business with £3000, which he utilizes as follows: £2000 for stock, £750 for lease of shop and goodwill, and £250 for fixtures. We will assume he keeps his books in a more or less rough-and-ready manner by single entry, and that at the end of each year's trading he endeavours to arrive at his financial position by subtracting the total expenditure from the total receipts. His book debts he sets off against the amount owing by him, and accordingly, as the former exceeds the latter, or *vice versa*, he adds the difference to, or subtracts it from, the balance of his receipts and expenditure account. The stock he always reckons to maintain at its original figure by purchases throughout the year, e.g.:

Total Book Debts	£1000
Total Creditor A/cs	750
Difference owing to him	£250
Total year's Receipts	£4000
Total year's Expenditure	3000
	£1000
Add difference owing to him as above	250
Result = Profit for year	£1250

The selling price of his goods he adjusts in accordance with the estimated profit so ascertained, i.e. with a view to increasing his business he sells more cheaply because he fancies that he can afford to do so.

As the years go by he finds more and more difficulty in paying his way. Many of his book debts are unrealizable, and as the stock gets out of date and deteriorates, the amount required each year to maintain it effectively increases. Eventually the lease has to be renewed, for which he has made no provision. Then he realizes that the excess of revenue over expenditure does not always represent profit, that in fixing the selling price of his goods he should have allowed a percentage to provide for the renewal of lease, deterioration of stock, and for bad debts.

As a further illustration of the importance of distinguishing between Capital and Revenue, let us consider the case of two persons A and B trading in partnership. A has ability and no money, B has money and no ability. The partnership deed provides that profits shall be shared equally between them. B stipulates that he shall prepare the accounts, which he does with a total disregard for the proper distinction between Capital and Revenue; no provision is made for depreciation of wasting assets, such as leaseholds and patents, nor for wear and tear of machinery. Vehicles wear

out, horses die, others are purchased to replace them, and the expenditure is charged to Capital Account. Meanwhile the partners are dividing "profits" up to the hilt. Then disaster overtakes the firm, the plant requires renewing, the lease of the premises has expired, patents have run out, the working Capital has all been expended, and the firm is without funds. It then dawns on B that part of the so-called profits which he has been drawing has, in fact, been a return of Capital; but worse has happened from his point of view, for A has also received a return of Capital, not his own, for he had none to start with, but B's.

With regard to the limited company, if it be an ordinary trading concern much that has been written above will of course apply; but there is this difference, that while there is nothing *legally* to prevent a private individual or firm from keeping accounts in a manner resulting in a return of Capital in the guise of profits, it is contrary to law for a company, registered under the Companies Acts, to pay dividends to its shareholders out of Capital, and directors sanctioning such a course may be personally liable for the amount of Capital returned to shareholders in this manner.

The question of what constitutes payment of dividends out of Capital as applying to companies, is one which bristles with difficulties, owing to the numerous, seemingly, more or less inconsistent decisions which have been given in the Courts on the subject. This matter is dealt with in the Chapter of this Part on "Company Accounts".

It is hoped that the few examples given will show how important it is to differentiate between what may be disposed of as legitimate profit, and what should be considered as return, or reimbursement, of Capital. If the distinction be ignored it will almost inevitably lead to the ultimate extinction of the Capital, and sometimes in so subtle a manner that the party primarily concerned is unaware that the process is in operation.

It may be thought that the investor would indeed be fatuous who invested in a mining undertaking yielding 10 per cent on his Capital, and imagined that the mine would last for ever; and the same may be said of a trader who did not recognize the fact that his lease became of less value each year. Yet such people do exist, and the writer has come across many examples of small manufacturers who, in estimating the price at which their manufactures should be sold, made quite inadequate additions to the prime cost for establishment charges, which, of course, should include all items properly chargeable to Revenue other than those directly incurred in the manufacture of the goods, such as raw material, wages, &c., which are included in the Trading Account and relate to prime cost.

ALLOCATION OF EXPENDITURE

In dealing with this matter it is first necessary to consider what expenditure is incident to a business, and this naturally varies with different classes of undertakings.

Classes of Expenditure

We will try to generalize, however, because there are certain expenses which are common to nearly all, and if we deal with these we shall cover a wide ground, and the principles enunciated will apply to almost any concern.

Capital is employed chiefly in the manufacture, distribution, and transport of commodities or things, and most individuals, firms, and companies engaged in business make use of their Capital either directly or indirectly with a view to making a profit in connection with one or more of these methods. In a going concern the Capital will be represented by certain assets, usually referred to as fixed, used for the purpose of dealing with the goods or things, and of certain other assets representing the things dealt with. To be more explicit, a manufacturer will have a factory, or the lease of a factory, and machinery, and he will also have raw material which he will convert into the goods he manufactures. The distributor will have his warehouses or, if he be a retailer, his shops, and he will have the goods he distributes. The carrier will have his steamships, or railways, or vehicles, but will usually deal only with the goods and things of others. Now in all these cases, in the process of earning profit, there will be occasioned certain expenditure which will leave no tangible result behind, that is to say, the result of the expenditure will be consumed in earning the profit, and there will also be occasioned a certain wastage or diminution in the value of the fixed assets, or some of them.

These expenses, whether in connection with what may be called the normal current outgoings of the business, or arising from the necessity of making good wastage of assets, are all proper charges against the profit, and must be taken into account before the amount of profit earned can be accurately ascertained.

In the case of the manufacturer and distributor the cost of the goods or things dealt with, and in all cases wages, lighting and heating, insurance, rent, rates and taxes, commission to travellers, salaries and management expenses, stationery, postages, &c., are all direct charges against the profit, and must be debited to the Revenue Account. On the other hand, the purchase of additional machinery, the acquisition of a freehold site for a new factory, the cost of the lease of additional shops, and the purchase of an additional steamship, are expenditure on Capital Account.

Twofold Nature of some Expenditure

It is not always easy to determine what expenditure should be debited to Revenue Account and what may, quite properly, be treated as expenditure on Capital Account. Indeed, experts are frequently in disagreement with regard to this matter, so nearly do certain items approach to the border line where the two classes of expenditure may be said to merge into each other. This arises, to some extent, from the fact that expenditure which may fall within the one category in a certain case may, under different circumstances, fall equally well within the other. Take, for instance, expenditure on advertising. This should usually be a charge against Revenue, it being an ordinary expense incurred in earning the profit, no tangible addition to Capital being represented by the sum expended. But suppose a firm, normally spending £2000 per annum on this item, decides to branch out into some new line, e.g. a retail drapery establishment opens a furniture department, and in order to let the world know that the firm now sells furniture in addition to drapery it is decided to spend in one year an additional £10,000 on advertising. The effect of this expenditure will probably be that a furniture business is created. Let us assume that this is so, that by a total annual expenditure of £3000 on advertising the sales in both drapery and furniture departments can be maintained, and that a yearly profit of £3000 accrues from the sale of furniture. Here then, partly at least as a result of the £10,000 spent in additional advertising, has been created a new business with a goodwill of considerable value, i.e., capitalized at three years' profits, worth £9000. The question arises, are you entitled to treat some part of that £10,000 expended on advertisements in excess of the usual amount, as Capital expenditure? We say undoubtedly yes. Of course, as a matter of prudence and sound finance, it would be advisable to write off each year, against the profit, a certain proportion of the amount, until it finally disappears from the Balance Sheet as an asset, in the same way as the item "goodwill" is treated by every well-managed concern whose financial position is strong enough to allow of this being done.

The purchase of plant, if merely for the purpose of replacing that which is worn out, must be charged to Revenue, although one can conceive circumstances where this requires modification. The cost of replacing, say, an obsolete engine by one costing more than the old one but doing twice as much work, may legitimately be apportioned between Capital and Revenue, the latter being debited with the value at which the old machine stands in the firm's books, and the difference being carried to the Plant Account.

The costs of Fixtures and Improvements are Capital items, but liberal sums should be charged to Revenue each year for depreciation, as, where premises are held on lease, the value of these items will usually be *nil* on the expiry of the lease, since they will revert to the lessor. Where the proprietors of the business own the freehold, the amount written off for depreciation of fixtures and improvements may be on a smaller scale.

General Principles of Allocation

It is of course impossible, within the limits of a short chapter, to give anything like an exhaustive number of examples to illustrate the proper allocation of Capital and Revenue expenditure, and for each class of business it will be necessary to examine carefully what effect the expenditure will have on the value of the assets forming the Capital of that business. Will the expenditure actually increase the value of those assets, so that they are capable of earning for the business a larger profit than previously? And can it reasonably be supposed that such increased profit will continue to accrue?

If the answer to these two questions is in the affirmative, then the expenditure may be debited to an account the balance of which will figure in the Balance Sheet as an asset. If the expenditure merely places the earning power on the same footing as it was originally—by reinstating worn-out or exhausted assets—then the expenditure must be charged against Revenue.

Economically, not a penny profit has been earned in a given period unless the value of the assets at the end of that period is at least the same as at the beginning; and the difference between the total value of the assets at the beginning and end of that period is profit or loss as the one is in excess of, or less than, the other. If expenditure is incurred for the purchase of an asset which will be

used up in a certain time, such, for example, as the rights in a patent, it may be regarded as Revenue expenditure paid in advance, and cut up into so many parts, each one to be debited to the Profit and Loss Account as the years go by. Those parts unappropriated at the end of any period are Capital, the parts appropriated, depreciation.

FIXED AND FLOATING ASSETS

The terms "fixed" and "floating", as applied to assets, are not used to describe any inherent, immutable qualities in the assets themselves, but rather to distinguish between the uses to which particular assets are being put in particular businesses, and it is difficult to conceive any description of property, capable of representing the assets of a business, which could not be classed either as "fixed assets" or "floating assets", according to the circumstances of their employment. To determine what are fixed and what floating assets it is necessary, therefore, to examine the nature of the business concerned. The fixed assets will be those which must be retained for the purpose of carrying on the business and earning the profit; that is to say, they are "fixed" in the sense that the intention at the time of their purchase was that they should remain an integral part of the business equipment, not to be disposed of whilst the business continues as a going concern.

Under this heading will come, as a rule, such items as Goodwill, Patent Right, Copyrights, Plant and Machinery, Freehold Land and Buildings, and Leaseholds.

The floating, or, as they are sometimes called, circulating assets, will be those which it is intended to convert into money, or turn over with as little delay as possible. For example, "Stock-in-trade", or the goods which it is a trader's business to sell, Book Debts and Bills Receivable.

What has been said with regard to the terms "floating" and "fixed" being interchangeable for the same kinds of assets, in accordance with the circumstances under which those assets are employed, will be readily appreciated from the foregoing definitions and the examples given below. Machinery will, in the case of a firm which manufactures it, come under the heading of "fixed assets" for the machinery used and "floating assets" for the machinery manufactured. A company formed for the purpose of buying and selling Freehold Land and Buildings will have to treat such property as a floating asset, for it is so under such circumstances, quite as much as the stock-in-trade of a retailer; and so with patent rights purchased by a firm, not with a view to working them, but as a speculation, for the purpose of an early resale.

The utility of dividing assets into these two classes is more apparent in connection with limited companies than with ordinary private undertakings, but one or two points arise with regard to the valuation of assets for Balance Sheet purposes, and in connection with the Profit and Loss Account, where the classification is of the utmost service. Fixed assets are, of course, usually subject to depreciation, but after making due allowance for this they appear in the Balance Sheet, as a rule, at their cost price, without regard to market fluctuations or other extraneous conditions. This is reasonable, since, taking the business as a going concern, most of the fixed assets will be worth to it, not their break-up value, nor what a willing purchaser would be prepared to pay for them, but rather their replacement value based on the original cost price, after depreciation has been taken into account. We refer, of course, to the more tangible assets, for an item such as goodwill can hardly be said to have a replacement value. The valuation of floating assets should be based on the sum that they can reasonably be expected to realize, but in no case should any estimated appreciation over cost be included. It may be noted that, in nearly every case, expenditure incurred in the purchase of floating assets is a charge against revenue.

WHAT ARE PROFITS?

The Profits of an undertaking may arise from three sources: i.e. (1) from excess of Revenue income over Revenue expenditure (which includes, in addition to actual outgoings, all items properly chargeable against Revenue), (2) from appreciation of fixed or floating assets, and (3) from the employment of a part of the Capital outside the business, e.g. interest on investments. It is absolutely essential that the accounts should be kept so as to show separately the income accruing from each of these three sources, if anything like an intelligent grasp of the possibilities of the concern, and the reasons of success or failure, are to be obtained.

The Profits derived from 1 constitute those arising out of the business proper, and in arriving at the amount earned in any particular period it is necessary to charge against it, not only the expenses which have actually been met, but also those which have accrued during the period and remain undischarged at the date of the accounts; and, conversely, it is permissible and right that credit should be taken for profit earned and not received, and for expenditure on Revenue Account paid in advance, that is, expenditure for which no benefit has yet been obtained.

With reference to 2, an increase in the value of fixed or floating assets should never be considered as profit until actual realization has taken place, as such increases are frequently only of a temporary character, and there is consequently in very many instances a strong possibility that the expected profit may never materialize. For example, a harness manufacturer purchases a quantity of leather, and subsequently the price of both the raw material and harness rises: when taking stock he finds that he has leather for which he paid £500, but which if purchased now would cost him £600. Here, then, is an apparent profit of £100, which, however, he may never obtain. For, in the first place, the profit will not accrue unless the price at which he can sell the harness made from this leather goes up proportionately; and, secondly, the price of leather may go down before he is able to turn it into harness.

It is usual to divide the Profit and Loss Account of an ordinary manufacturing or trading concern into—

(*a*) A Trading Account, showing the gross profit, i.e. the total amount for which the goods have been sold, less their cost price, without taking into account establishment and indirect charges against revenue, such as depreciation.

(*b*) A Profit and Loss Account proper, showing the net profit, in which the establishment or management expenses and all other revenue charges are debited against the gross profit disclosed by the Trading Account.

Where there is any income or expenditure on Capital Account a further division is usually made.

The Revenue Account (or, where this is subdivided, Accounts) of every business should, in so far, of course, as the items enumerated below are applicable, show separately—

1. The cost of production, including raw material, or, for a merchant simply, the cost of goods purchased.
2. The cost of distribution.
3. The cost of maintenance.
4. The cost of management or administration.
5. Provision for depreciation and bad debts.
6. Cash discounts allowed to debtors.
7. Interest on borrowed capital, and cost of discounting bills.

All these will appear on the Debit side of the account; the following on the Credit side:—

8. Value of goods sold.
9. Discounts obtained.
10. Income from investments.
11. Interest from money on deposit, or in respect of the renewal of bills for customers.
12. Income from other sources, such as royalties.

Each one of these items requires to be considered in connection with the question of "What are Profits?", and it is proposed to deal with them *seriatim*.

The Cost of Production

This includes the cost of raw material, wages, carriage inwards, cost of power, i.e. electricity or gas, factory rent, rates and taxes, &c.

In the case of a trading concern which does not manufacture, the cost of the goods, plus carriage, may be said to be the "cost of production".

Now the cost of raw material, or goods, to be debited to the Profit and Loss Account is not the total amount purchased during the period, but the amount used or sold. This is ascertained by adding the amount purchased to the stock at the beginning of the period, and deducting from the result the stock at the end. All goods purchased and received should be taken into stock, but it often happens that goods are received before the invoices come to hand, and this should be borne in mind with a view to ensuring that the value of every unpaid item included in the stock has been credited to the party concerned, otherwise the value of such goods will go improperly to augment the profit.

The question of the valuation of stock is a most vital one when dealing with the matter of "Profits": the proper value to be placed upon the stock is cost price or market value, whichever is the lower, less a percentage, varying with the class of business, for deterioration. Some manufacturers and traders endeavour to equalize their Profits by writing down the value of the stock in good years and writing it up again in bad years. The amount of profit can be so easily manipulated in this manner, that there is often a strong temptation thus to obtain the result wished for, but the practice is strongly to be deprecated. (See also Chapter XIII of this Part.)

The stock of a manufacturer will consist of

(*a*) raw material, (*b*) goods partly manufactured, and (*c*) finished goods. These should be valued for stocktaking purposes as follows: (*a*) at cost or market price, whichever is the lower, less depreciation; (*b*) at cost of material plus the cost of labour actually expended on them; (*c*) the same as (*b*), with the addition of a percentage to cover a proportion of the cost of factory rent, power, and other expenses directly incurred in the manufacture. This percentage must not, of course, include the estimated profit which it is hoped to make when the manufactured articles are sold.

In the case of manufacturers who are also retailers the practice is sometimes adopted of valuing the stock of finished articles at the price at which they could be purchased wholesale elsewhere; that is to say, the two branches of the business, manufacturing and trading, are kept entirely distinct in the books, and credit is taken for the manufacturing profit as soon as the goods are completed, but before they are sold. We do not like this method, although to a certain extent it is legitimate. Overproduction in the factory, or a bad year in trading, might easily result in a paper profit which would be, to say the least, very misleading.

With regard to rent, rates, and taxes, where the due dates do not synchronize with the end of the period covered by the accounts, care should always be taken to see that the correct proportion is debited to the Revenue Account. This remark also applies to gas and electricity, and to any items which accrue from day to day and become payable at a fixed date.

Where the end of the period under review falls in midweek, the weekly wages must be allocated in the same manner. (See Chapter II of this Part.)

The Cost of Distribution

We may divide this into two parts: (*a*) expenses directly incurred in distributing, such as wages of salesmen, carriage outwards, packing charges, petrol for motor vans, or food for horses, wages of carmen, &c.; and (*b*) expenses incurred with a view to increasing the sales, such as salaries and commissions of travellers, advertising, cost of catalogues.

The item under (*a*) need not detain us after what has been already written under the heading of "Cost of Production", and the question of advertising has been fully discussed elsewhere.

With regard to commissions, care should be taken that those due in respect of the sales completed during the period covered by the accounts are charged against the profit. Catalogues, especially if illustrated, are sometimes very costly; and if any considerable sum is expended on them at one time, and the catalogue is likely to remain current for a year or two, it may be permissible to carry some of this expenditure over to the next Profit and Loss Account instead of charging the whole against the sales of the one period. In a matter of this kind those responsible must exercise their discretion very carefully, always remembering that it is better to err on the side of prudence than to take credit for a doubtful asset.

The Cost of Maintenance

The cost of Repairs or Renewals, and all expenses for the purposes of keeping the fixed assets in a state of efficiency, must be taken into account before the profit can be ascertained. A profit shown without proper provision under this heading is only a delusion.

The Cost of Management

This comprises office rent, rates, taxes, salaries of managers and clerks, postages and stationery. These are, of course, all charges against the Profit. With reference to rent, this is usually paid after it has accrued; and if payment is not due at the date of the accounts, the proper proportion relating to the period must be debited to the Profit and Loss Account as already mentioned. Rates, on the other hand, are usually paid in advance; and if there be unexpired any part of the period covered by the rate, credit should be taken for the proportionate amount.

Provision for Depreciation and Bad Debts

The question of depreciation cannot be dealt with here anything like fully; the subject is too wide, and the methods of making provision for it too varied to allow of more than a passing reference. Nearly all assets are subject to depreciation, and the rate varies according to the class of assets. The idea should be to reserve from time to time out of the income of the business, such sum or sums as will be sufficient to replace every asset subject to depreciation, when its value to the business shall have become extinguished. (See also Chapter of this Part on "Reserves, &c.")

Some assets, such as machinery, will have a residual value, and in making provision for the time when replacement will be necessary this value should be considered, and the amount to be written off for depreciation will be calculated accordingly. Other assets, such as leaseholds, have no residual

value, sometimes quite the reverse, and full provision should be made, not only for the diminishing value of the lease, but also for any contingent liability for dilapidations.

But the real point, so far as the question relates to Capital and Revenue, is, that provision must be made for any diminution in the value of the assets before any profit can be shown.

There is only one way to avoid making Bad Debts, and that is to have no debtors, which is practically an impossibility, since our whole commercial system is built up on credit. It might be thought that the defalcation of a debtor constitutes for the creditor a loss of Capital; but the fact that bad debts are inevitable for nearly all businesses has resulted in them being considered as a charge incurred in earning the profit, i.e. a Revenue expense; and it is essential not only that the debts which are actually known to be bad should be debited to the Profit and Loss Account, but also that provision should be made for any others by the creation of a Reserve for Bad Debts. Such a Reserve is usually created by crediting a Reserve Account with a percentage of the total amount owing by debtors, and debiting Profit and Loss. In subsequent years, debts which are known to be bad are then debited to the Reserve Account, the balance being adjusted so as to form the same percentage as before, of the total amount owing, by debiting (or crediting as the case may be) the Profit and Loss Account with the required amount.

Cash Discounts allowed to Debtors

Where the debts have been discharged any discount allowed must, of course, come off the profit, but there remain the undischarged debts, the total amount of which will appear in the Balance Sheet as an asset. Discount will probably have to be allowed on these also when they are settled, and it is necessary, therefore, in estimating the profit to make allowance for this contingency by means of a Reserve as in the case of Bad Debts.

Interest on Borrowed Capital and Cost of Discounting Bills

If there is not sufficient Capital in the business, and money has to be borrowed, it is evident that a portion of the Profits, i.e. that represented by the above items, are not earned by the business, but by Capital outside the business. They must therefore be deducted from the total Profits. The accrued interest unpaid for the period covered by the accounts must be ascertained and debited to the Profit and Loss Account, a Reserve or Suspense Account being opened and credited with the amount.

All the foregoing are charges against the profit or expenditure on Revenue Account. We now have to consider the income from which they have to be deducted, the difference being the actual profit or loss as the case may be.

Value of Goods Sold

It is from this source that the bulk of the profit will be derived; the value of all goods returned must of course be deducted from the total.

Credit must not be taken for the profit on any goods consigned to another party for sale until the goods have actually been disposed of, after which the consignee will become liable for the amount realized, less his commission and any legitimate expenses incurred by him in connection with such goods. Those unsold at the date of the accounts should be taken in the Balance Sheet as an asset at their cost price.

Cash Discounts obtained

Credit should only be taken for those discounts which appear in the Cash Book, and therefore relate to debts actually settled.

Although it may be tolerably certain that discount will be allowed in respect of some of the outstanding accounts of creditors, it is neither prudent nor good accounting to anticipate such profits by crediting the Profit and Loss Account before the debts have been discharged.

Discount received in respect of Capital expenditure should be regarded, not as a profit, but as going to reduce the price paid for the asset to which it relates, the value of which will appear in the Balance Sheet at the net price, subject of course to any amount it may be considered advisable to write off for depreciation.

Income from Investments

Credit may be taken for any unpaid interest which has accrued in respect of the period covered by the accounts, where the rate of such is known, and there is a practical certainty that the cash will in due course be received. This will apply to cases where the investment is represented by Government or municipal bonds or first-class debenture stocks; but in the case of ordinary or even preference shares it is advisable to wait until the dividend has been received, or, at any rate, declared,

since estimates in respect of this class of investment often, unfortunately, lead to disappointments.

Interest from Money on Deposit or in respect of the Renewal of Bills for Customers

These present no difficulty. The first will be credited from time to time in the bank passbook, and from thence will be entered in the Cash Book and credited to the Interest Account. The second will be debited to the customer when the bill is renewed, and credited to Interest Account, the balance of which will be transferred to the credit side of the Profit and Loss Account when the accounts are made up.

Income from Other Sources

Whether credit may be taken for the above before actually received will depend on circumstances, i.e. whether the exact amount is known (estimates are always dangerous), and whether it may be reckoned beyond all reasonable doubt that the amount will be received.

The question of what are Profits has been dealt with principally from the private trader's point of view, but the principles to be deduced will apply to almost any undertaking. There will be special considerations necessary for different kinds of enterprises, especially with regard to public companies and certain classes of business peculiar to them, but these are dealt with elsewhere in this work.

CHAPTER IV

BALANCE SHEETS

Introductory—Preparation of Balance Sheets—Form and Marshalling—Limited Companies—Working Capital and Loss of Capital—Detailed Analysis—Contingent Liabilities—Private Firms' Balance Sheets—Preparation by Single Entry.

INTRODUCTORY

If it is desired to show the position of an undertaking at any given time, it is necessary to prepare a Statement of Account giving all the requisite information. In the case of a concern keeping proper books of account on a double-entry basis, such information will be recorded in the books of account; but where only an imperfect system of bookkeeping is in use, or a single-entry system, some information may have to be gathered from other sources. This Statement of Account may either be in the form of a Balance Sheet, usually employed to show the position of a going concern in the ordinary way, or in the form of a Statement of Affairs, which is almost exclusively used to show the position of a concern that is expected to be wound up because of insolvency. These two Statements differ considerably not only in form, but in the figures disclosed, and in this chapter the Balance Sheet only will be considered. (As to Insolvency see Chapter XI of this Part.)

A properly prepared Balance Sheet of a business will disclose all the information necessary to form a true estimate of the position of affairs, assuming that the business is to continue as a going concern. One thing that a single Balance Sheet does not disclose, is information as to the progressive nature or otherwise of the business. It may perhaps give some indication as to it, but this is not often the case. A series of Balance Sheets, however, will show not only the position of affairs at the dates of the same, but also what progress or otherwise has been made between the dates covered.

PREPARATION OF BALANCE SHEETS

The basis of and method of preparation varies with the system of bookkeeping employed. As, however, the majority of businesses have a proper system of bookkeeping, it will be assumed that we are dealing with such a case, leaving the consideration of the special characteristics of a single-entry system to a later point.

At any given time the books should contain all the information necessary to the preparation of a Balance Sheet with one exception. The exception which decides the question whether or not a Balance Sheet can be prepared is the value of the stock-in-trade in hand. In the case of businesses which do not carry any stock this question does not arise, but in a trading concern the amount of stock in hand varies from day to day, and in order to arrive at the stock at any given time it is necessary to make a valuation of it. This is known as the Stocktaking, and consists in finding the quantities of the various articles, and afterwards valuing them according to certain principles to be discussed later.

When the books are examined, it will be found that some accounts are not closed, but that there are balances open upon them. A Trial Balance should be prepared and the books balanced, and this Trial Balance will then show all the open balances. A careful consideration of the balances

will show that they can be divided into two distinct classes.

One set will be found to represent the result of transactions that have passed, i.e. the losses or expenses if debits, and receipts or gains if credits, that have occurred during the period.

The other balances will be found to represent existing facts, i.e. assets due to the concern if debits, and liabilities due by the concern if credits.

The first series of balances will be used in the preparation of a Profit and Loss Account by transferring all debits to the debit of the Profit and Loss Account or some subdivision thereof, and credits to the credit of the said account. By this means, this series of balances will be replaced by one balance representing the profit or loss during the period. The remaining balances, together with the balance of the Profit and Loss Account, will be incorporated in the Balance Sheet.

It is essential that the two classes of balances should be rigidly separated, for while the accounts would balance even if this were not done, the results of including a loss amongst the assets (which would happen if a debit balance which should have been written off to the Profit and Loss Account were included in the Balance Sheet), or of including a liability amongst the gains, would be gravely erroneous.

The next step will be to classify the various balances. For instance, there may be many amounts due to the concern in respect of goods supplied, in some cases running into thousands of items, and these will all appear in the Balance Sheet as Sundry Trade Debtors; and in order to arrive at the amount a schedule will have to be prepared showing all the items coming under this head. Similarly all trade liabilities will be grouped under the heading of Sundry Trade Creditors.

In addition to grouping items of the same kind, in accounts of some intricacy it may be necessary to bring together a variety of different balances, to separate a balance into different items, or to deduct some balances from others, in order to show the desired information on the Balance Sheet. Take, for instance, the case of a limited company formed in England and carrying on business in a country where it is necessary to form another company in order to comply with local laws. The shares in the subsidiary company will all be held by the English company, but it is usual to show as assets of the company, not the shares in the subsidiary company, the value of which appears in its books, but the various assets held by the subsidiary company.

All such groupings should be recorded on properly prepared schedules, so that an explanation as to how an amount was arrived at may always be available.

FORM AND MARSHALLING

In form there is no hard-and-fast rule. As a general practice the Balance Sheet is prepared in the form of an account. That is to say, the left-hand side is marked *Dr.*, and the right-hand side *Cr.*, and all debit items commence with "To", and all credit items with "By". For example:—

X., Y., Z., & Co., Ltd.

Dr. Balance Sheet, 31 December, 1912. *Cr.*

To Issued Capital...	£5000	By Goodwill.....	£1000
" Trade Liabilities	650	" Premises.....	2000
" Secured Loans...	1000	" Plant and Machinery.....	2000
" Profit and Loss Account Balance.....	250	" Sundry Debtors	1500
		" Cash.....	400
	£6900		£6900

Strictly speaking, however, a Balance Sheet is not an account, it is a statement. Accordingly many accountants do away with the "To" and "By" and *Dr.* and *Cr.*, in which case the *Dr.* side will be headed "Liabilities" or "Capital and Liabilities", and the *Cr.* side "Assets" or "Property and Assets".

In the form indicated in the example it will be noticed that the liabilities are placed on the left-hand or debit side, and the assets on the right-hand or credit side. This is the general rule amongst English accountants, but some reverse this order. Another variation which is not much used in England is to place the liabilities first, and then place the assets afterwards. This practice is common in America, and some of the English banks use this form for their monthly statements.

In the further detailed consideration of the composition of a Balance Sheet it will be assumed that it is in the first form.

LIMITED COMPANIES

In view of the great importance of the Balance Sheet of a limited company, in which case an audited Balance Sheet is a statutory requirement, and the relative unimportance of the Balance Sheet of private firms, the consideration of the special features of the latter will be dealt with further on, and the Balance Sheet of a limited company will now be dealt with. Companies incorporated under special Acts of Parliament are usually compelled to keep special accounts.

The order in which the various items appear, or the Marshalling of Liabilities and Assets, as it is called, is also a matter in which some differences of opinion exist. The Marshalling of Liabilities is, however, nearly always in the following order:—

Share Capital.
Debenture Capital.
Loans.
Trade Creditors.
Profit and Loss Account.

Other items, such as Reserves, come in after the first two items and before the last item.

In the Marshalling of Assets, however, there are two quite distinct methods in general use. One method is to place the most easily realizable asset first, followed by the assets less easily realizable, so that the last item will be the most difficult to realize, or at any rate the last one it would be expected to sell. The following is an illustration of this order.

Cash at Bank and in hand.
Sundry Debtors.
Stocks in hand.
Loose Tools.
Plant and Machinery.
Leasehold Premises.
Goodwill.

The more common method, however, is to marshal the assets in exactly the reverse order to this, commencing with, say, Goodwill and finishing with Cash.

It has been stated that all liabilities appear on one side of the Balance Sheet and all assets on the other side. An examination of the items will, however, disclose items amongst the liabilities which are not owing by the company, and items amongst the assets which do not represent any value.

It will be found that the items comprised in the liabilities can be divided into the following classes:—

1. Liabilities to Shareholders.
2. Liabilities to Debenture Holders.
3. Liabilities to Trade Creditors.
4. Loans.
5. Reserves.
6. Undistributed Profits.

The first item is not repayable by the company, and is only recoverable in the event of liquidation, and funds being available, and this is therefore not an ordinary liability.

The fifth item, too, is not an amount payable by the company, nor is the sixth item, until a dividend has been declared.

The assets, on examination, will be found to consist of visible assets and those that cannot be seen. The former can be divided into Fixed Assets and Floating Assets.

The invisible assets, if represented by existing value to the concern, are called Intangible Assets. If, however, there is no existing value attaching to any such item, there is no ground for calling them assets at all, and they are therefore called Fictitious Assets. It may be asked: Why should these Fictitious Assets appear on a Balance Sheet? It may be because there is no revenue with which to extinguish them, or it may be that custom has ruled that they may be included. In any case it is important to recognize them, because in considering the position of a business any Fictitious Assets must be eliminated (see p. 156).

WORKING CAPITAL AND LOSS OF CAPITAL

Before reviewing the components of the Balance Sheet in detail, it may be well to consider what is known as the *Working Capital*. Upon the sufficiency of this the possibility of success of an undertaking will in a large measure depend, for if it is inadequate, the operations will be cramped and the ability to earn profits limited. This may be by reason of being unable to buy in the cheapest market and take all possible discounts, or to carry sufficient stocks, or to give the usual credit allowed to customers.

The amount of Working Capital is represented by the excess of Floating Assets over the current liabilities at any given time. The current liabilities are the amounts due to Trade Creditors, Bills Payable, Temporary Loans, Bank Overdrafts, and generally all amounts which the concern is called upon to repay. Share Capital not being a repayable item, and Debentures only under certain conditions, they are not considered as liabilities in this connection.

The floating assets consist of such items as Cash, Debts, Stocks, Bills Receivable, Temporary

Investments, and generally such items as are intended to be converted into cash.

In order to form a correct estimate of the sufficiency or otherwise of the Working Capital, it is necessary to have access to considerably more information than is usually disclosed in the published accounts; but if included amongst the liabilities there are Bank Overdrafts or Loans, it is evident that the cash resources have had to be augmented by these means, and that the Working Capital is insufficient for requirements.

It may also be well to consider here the question of *Losses of Fixed Capital.* It has been decided in *Bond v. Barrow Hematite Steel Company* (1902), that Fixed Capital may be sunk and lost, and yet that the excess of current receipts over payments may be divided. In other words, the capital sunk in the acquisition of assets necessary for the carrying on and revenue-earning capacity of the business may be lost, either wholly or in part, without impairing the ability of the company to pay dividends out of the ordinary profits of the business. For example, a company may purchase a gold mine in order to extract the gold therefrom. At an unknown date all the gold will be extracted and the empty mine will be practically without value, and the capital sunk in the purchase of the mine will then be absolutely lost. This loss has not to be made good out of revenue, which can be fully distributed amongst the shareholders by way of dividend. (See also Chapter III of this Part.)

The fixed capital will be represented in the Balance Sheet by the Fixed Assets and partly by some of the Intangible Assets (such as Goodwill), and it therefore follows that these items may appear at a much higher figure than their actual value without any provision being made for the loss that has occurred.

As a matter of general practice, however, a good deal broader view is taken than this, and known losses are usually written off or provision made for depreciation; so much so, that in many cases an auditor will report the fact if proper provision is not made for the depreciation of fixed plant or for leasehold property. On the other hand, it is unusual for any provision to be made for the loss that will occur when a mine is worked out or oil lands worked dry, but reserves are sometimes made out of the balance of profits to meet such losses of capital.

DETAILED ANALYSIS

Liabilities to Shareholders

Under this heading will fall the amount of the paid-up capital of the company.

The Companies (Consolidation) Act, 1908, provides that the capital shall be divided into shares of a certain denomination (see Part III, Chapter IV). It is not permitted to issue shares at less than their face value, but they need not be paid up to the full amount, for the company may call up only what amount is required. The shareholders, however, are liable to pay the face value of the shares taken by them when called upon by the company to do so. The shares may be issued subject to payment in cash, or may be issued for some other consideration either fully paid or partly paid up, but in this case it is necessary to file at Somerset House a properly executed and stamped agreement.

The Share Capital may be divided into several classes of shares—Ordinary, Preference, Deferred, and Founders', each with special rights and privileges, and each class may include shares partly or fully called up, and the so-called Liability to Shareholders consists of the total of the paid-up capital of all classes of shares.

There is, however, no liability on the part of the company to repay this share capital, and the only way the shareholder can realize his shares is by sale, except in the event of the liquidation of the company. In the case of liquidation, shareholders will be entitled to have divided between them, in proportion to the amounts paid up on their shares, the whole of the assets (if any) remaining after paying for the costs of liquidation and discharging all other liabilities of the company.

On the other hand, if the company goes into liquidation and there are any shares which have not been called up to their full face value, the holder of such shares will be liable to pay up the unpaid amount. It follows that if a Balance Sheet shows there is an amount of Issued Capital which is not fully called up, this is a further asset that will be available to meet the claims of other creditors of the company should the other assets be insufficient for that purpose. It will be found that most Joint Stock Banks have a large reserve of uncalled capital for the security of those with whom it does business. From the point of view of the shareholder, shares having any considerable amount of liability for calls not made are not altogether desirable, in view of the impossibility of transferring the shares in the event of the company falling upon bad times.

The amount of the capital that has been authorized should be shown on every Balance

Sheet by way of a note, as this figure does not form part of the actual Balance Sheet.

If there should be any amounts owing by shareholders in respect of calls that have been made, these should be deducted from the amount of the paid-up capital and not shown as an asset.

The following is the usual form of stating the capital:—

To Capital:				
Authorized ...	1,500,000	Ordinary Shares of £1 each	£1,500,000	
	500,000	Deferred Ordinary Shares of £1 each ...	500,000	
	2,000,000		£2,000,000	
Issued... ...	1,250,000	Ordinary Shares of £1 each, issued fully paid	£1,250,000	
	250,000	Ordinary Shares of £1 each, upon which 10*s.* has been called up	125,000	
	500,000	Deferred Ordinary Shares of £1 each, fully called up...	500,000	
			£1,875,000	
		Less Calls in Arrear	1,520	
				£1,873,480

Forfeited Shares

The Articles of Association of a company usually empower directors to forfeit those shares upon which the holders have not paid the calls that have been made, in which case the original holders lose all rights to the shares, which may be again issued. If this happens, the amounts paid up on the shares that have been forfeited will be credited to a special Forfeited Shares Account. This does not represent a liability of the company, for the original holders have no claim upon it, and it is not a profit that can be distributed amongst the shareholders. It must therefore appear as a separate item on the Balance Sheet, and is in effect a reserve. This reserve may be used in order to issue shares at a discount, provided the total amount of such discount does not exceed the amount paid up on the forfeited shares.

It is important to note from the shareholder's point of view that forfeiture does not relieve him from further liability, for although he loses all rights to the shares, he may still have to pay all the unpaid calls made before forfeiture.

Debentures

Most companies are empowered to borrow money upon the security of their assets, such loans being secured by debentures or debenture stock. The security given may be wide enough to cover every form of asset that the company may possess, including uncalled capital. Usually trustees are appointed to whom the fixed assets are specifically mortgaged, with a floating charge upon all other assets that may come into the possession of the company. In this case the fixed assets cannot be dealt with by the company without the consent of the trustees; and if any are sold the proceeds must as a rule be paid into a special Bank Account over which the company has no control, and which will either be reinvested for the benefit of the debenture holders or be applied towards redeeming some of the debentures. The interest is payable periodically at a fixed rate, and is secured equally with the principal sum. The debentures, however, are not repayable on demand, but at a fixed date, except in the case of default in payment of interest, or in certain other cases when the security of the debenture holders is jeopardized.

It will be seen that the liability of a company in respect to its debentures is of paramount importance, for all its assets may be called upon to satisfy this liability, and nothing is available for ordinary creditors or shareholders while any sum is due to the debenture holders.

In a Balance Sheet any amount of interest accrued on the debentures must be shown as a separate item and not included with other liabilities. It is not usual to state what assets are given as security, but it may be assumed that all assets are so pledged.

From the point of view of a trader giving credit to a company with a debenture debt the matter is of considerable importance. In the event of being unable to obtain payment in the ordinary course of business, it is almost impossible to obtain it through the Law Courts, for the trustees for debenture holders will not allow distraint to be made upon any assets which are included in their security, because they can put a receiver in possession of the property on their behalf. For this reason a company having a debenture debt finds a difficulty, before having made a reputation for sound-

MAKERS OF MODERN BUSINESS—VII

CECIL JOHN RHODES (1853–1902); born in Hertfordshire; entered Cape Colony Parliament, 1881; Treasurer-General of Cape, 1884; Managing Director of British South Africa Company, 1889, afterwards Chairman; Director of De Beers mines; Premier of Cape Colony, 1890–96.

SIR CLIFTON ROBINSON (1849–1910); born in Birkenhead; made first tramway in Europe in Birkenhead, 1860, and greatly developed tramway traction thereafter; knighted, 1905.

LORD ROTHSCHILD; born in London, 1840, son of an Austrian Baron Rothschild; head of great financial house of Rothschild; succeeded uncle in baronetcy, 1876, and father in Austrian barony, 1879; created British Baron, 1885.

JOSEPH ROWNTREE; born in 1836, a Quaker; Chairman of Rowntree & Co., Ltd., cocoa and chocolate manufacturers, York.

JOHN RYLANDS (1801–88); born in St. Helens; a cotton manufacturer, with largest textile concern in Britain; his widow erected the John Rylands Library at Manchester as a memorial of him.

SIR TITUS SALT (1803–76); born at Morley, Yorkshire; entered the wool-stapling business at Bradford; laid the foundations of the alpaca industry in 1836; built the model town and factory of Saltairé, near Bradford; Mayor of Bradford, 1848; Liberal M.P. for Bradford, 1859–61; Baronet, 1869.

SIR RICHARD SOLOMON; born at Cape Town, 1850; called to Bar, 1879; Attorney-General of Cape Colony, 1898–1900, of the Transvaal, 1902–07; Agent-General in London for Transvaal, 1907–10; High Commissioner for Union of South Africa since 1910; K.C.M.G., 1901, K.C.B., 1905, K.C.V.O., 1907, G.C.M.G., 1911.

SIR ALBERT SPICER, BART., M.P.; born in London, 1847; a Director of James Spicer & Sons, Ltd., wholesale stationers and paper merchants; President of London Chamber of Commerce, 1907–10; President of Congress of Chambers of Commerce of the Empire, 1909; Liberal M.P. for Monmouth Boroughs, 1892–1900, for Central Hackney since 1906; Baronet, 1906.

LORD STRATHCONA; born Donald Alexander Smith in Scotland in 1820; entered Hudson's Bay Company, of which he is now Governor; a Director of the Canadian Pacific Railway; High Commissioner for Canada, 1896–1911; K.C.M.G., 1886, G.C.M.G., 1896, Baron, 1897, G.C.V.O., 1908.

Russell

CECIL J. RHODES

Vandyk

SIR CLIFTON ROBINSON

Russell

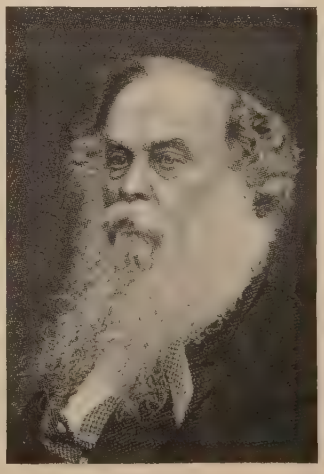
LORD ROTHSCHILD

Debenham, York

JOSEPH ROWNTREE

A. Debenham

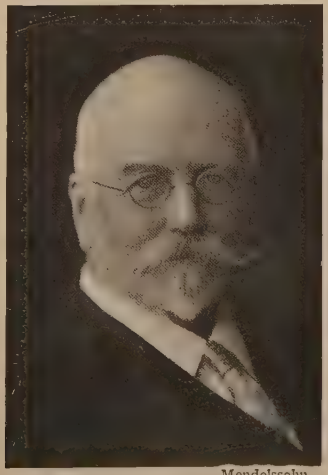
JOHN RYLANDS



SIR TITUS SALT

Elliott & Fry

SIR RICHARD SOLOMON, G.C.M.G.



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SIR ALBERT SPICER, BART., M.P.

Russell

LORD STRATHCONA

ness, in obtaining the credit that would ordinarily be given to a company without debentures.

The shareholders' point of view of debentures is rather different. While it is equally true that the debentures will come before them, both for interest and the capital sum, it is in other respects more advantageous to borrow money at a comparatively low rate of interest upon the security usually given to debenture holders than to issue more shares which would have to share in the profits.

The terms of issue of debentures afford a valuable index of the position of a company, at any rate at the date of issue.

Debentures may be issued (*a*) at par; (*b*) at a premium; or (*c*) at a discount. In the first case the statement on the Balance Sheet of the amount of the liability to debenture holders discloses the whole of the facts, for the company has received value to the same amount. In the second case the liability to debenture holders is less than the amount which has been received by the company to the extent of the premiums received. These premiums do not represent a profit which should be distributed amongst the shareholders, but one which must remain amongst the liabilities, and is in effect a reserve. In the third case the company has had to accept a liability greater than the amount it has received, and therefore, while amongst the liabilities there will appear the full amount of the debentures issued, a smaller amount has come into its coffers, less than the amount of the debentures by the discount at which they were issued. A fictitious asset will therefore have been included representing this discount, and will appear on every Balance Sheet unless and until it has been written off out of other profits.

Any item of this description which appears amongst the assets not only shows that at the time of issuing the debentures additional inducements had to be offered, but also that there is still a so-called asset which is not represented by value.

The rate of interest on debentures is also an indication of the esteem in which the company was held, a low rate denoting that the security offered to the debenture holders was good enough to ensure a small risk of loss of the capital sum, whereas a high rate shows that there was a larger risk of losing the amount advanced.

Liabilities to Trade Creditors

These are usually shown in one amount, and even if large do not call for special comment, for the sounder a business is, the easier is it to obtain large credit, while a business that is the reverse of flourishing finds more difficulty in obtaining credit. There is, however, one point upon which there is some difference of opinion, and that is with regard to the discount that will be deducted upon paying these creditors.

One practice is to deduct from the amount of the trade creditors the discount which is usually allowed. But in view of the fact that this discount depends upon payment on the due date, in the event of payment being delayed beyond that time the discount is lost, and the creditors would have been understated by that amount. On these grounds no deduction is often made in respect of cash discounts. The other view is that in the case of a company which always takes the discounts that can be obtained by prompt payment it is only fair to assume that the trade creditors will be paid less discounts, and that this deduction should be made in stating the liabilities for a Balance Sheet.

Bills Payable, which are usually in respect of Trade Liabilities, should be shown as a separate item, as in the event of non-payment at the due date they can be sued upon without having to prove the delivery of goods, &c., in the way that an ordinary creditor has to do.

Loans

Any loans made to a company, whether on security or not, should be shown as a separate item in a Balance Sheet. It is a very objectionable practice to include these with the ordinary trade creditors, because loans are necessary in order to increase the cash resources ordinarily available, or are the result of bad finance. Any interest that may have accrued or be due at the date of the Balance Sheet should also be disclosed, which is commonly done in the following manner:—

Loans	... £6000	
Interest accrued thereon ...	... 42	
		£6042

If any security has been given, this fact should also be stated, either as a note to the item of loans, or, more generally, as a note to the asset given as security that it has been so pledged.

The most usual form of loan for which security is required is a bank overdraft, in which case portions of the property may be charged and the deeds relating thereto deposited with the bank as security, or investments may form the security, the scrip for which will be lodged with the bank.

Reserves

Apart from the question of investing reserves inside or outside the business, which is considered fully in another Chapter of this Part, there are two distinct kinds of reserves.

One reserve is the amount that it has been considered necessary to provide by way of a charge against the Profit and Loss Account in order to reduce to a proper figure certain assets appearing in the books at a higher figure than they are expected to realize. The best method of showing this is to deduct the amount of the reserve from the asset to which it relates. For example:—

Sundry Debtors	£4326 3 4	
Less Reserve for Bad and Doubtful Debts and Discounts ...	250 0 0	
		£4076 3 4

From this it is clear that while the debtors on the books amount to £4326, 3*s.* 4*d.*, it is considered that this will not be realized, owing to debts that may be bad either wholly or in part, or by the discounts which will have to be allowed, these being estimated at £250. If, however, the sundry debtors appear amongst the assets at the gross figure of £4326, 3*s.* 4*d.*, and the reserve is placed amongst the liabilities at £250, these two figures must be read together in order to find the exact position. This method is often adopted, and any reserves which appear amongst the liabilities and which are definite reserves against the overvaluation of assets appearing on the other side, must be considered in relation to the said assets. Particular attention should therefore be given to these reserves, and it is in all cases advisable to show them deducted from the assets.

The other kind of reserve is a sum provided out of the profits that have been earned, which, instead of being distributed amongst the shareholders, has been set aside and either used in the business so as to provide additional working capital, or invested in the business for extensions, or invested outside the business so as to provide an amount of cash that can be readily obtained should occasion require.

This kind of reserve may be made to equalize dividends, to provide for replacements of wasting assets which it is not necessary to charge against profits, or merely in order to retain cash in the business which would otherwise be distributed by way of dividend.

Such reserves are in effect undistributed profits, and are not liabilities of the company, and constitute therefore a measure of strength in its financial position.

Undivided Profits

It is unusual for a company to pay away the whole of its profits as dividends to shareholders, and if there is any profit which has neither been divided amongst the shareholders nor allocated to a reserve, this will appear as a credit balance amongst the liabilities on a Balance Sheet. Such an item is really a reserve and not a liability. It is quite true that a dividend may be declared which would absorb this balance, and it would then be a liability to the shareholders; but until that event there is no liability on the part of the company in respect to this item.

In this connection it may be mentioned that in companies where there are many shareholders dividends that have been declared are not always claimed by the shareholders, and these will appear amongst the liabilities. Any such unclaimed dividends should be shown separately in the Balance Sheet, for in the event of liquidation they would rank for payment after the ordinary creditors had been paid in full.

Fixed Assets

The fixed assets of a business consist of the visible assets that have been acquired to enable it to earn revenue or to carry on its operations. They are of a more or less permanent nature, and are intended to remain in their present form while the purpose for which they were acquired continues to exist, whereas the floating assets are intended to be converted from their present form into another form as opportunity arises. Included under this heading will be found such items as the Mine of a Mining Company, Land and Buildings, Fixed Machinery, &c. From some points of view the Goodwill might be considered as a fixed asset, but as it is not a visible one it is usually considered as an intangible asset and will be so dealt with here.

The mine of a mining company will usually appear on the Balance Sheet at cost plus the cost of additions and improvements during the period since the previous Balance Sheet, i.e.:

Mining Property as per last Balance Sheet	£25,000	
Additions and Improvements (or Expenditure thereon) during the year ...	250	
		£25,250

It is not usually considered necessary to provide for the obvious loss in value by reason of the ores that have been extracted. It is important, however, that any additions to this item should actually increase the value of the property, and an auditor will require adequate proof as to this before certifying the Balance Sheet. All companies which are owners of property that is being worked or developed for the purpose of obtaining profits therefrom will treat their Property Account in a similar way, and the additions to this item will therefore vary according to the

nature of the principal asset. In the case of a mine the cost of sinking the main shaft is probably rightly considered as a permanent improvement, but ordinary development should not be added to the Property Account, for while it may rightly be considered as a good asset at any particular date, this development is really in the nature of preparatory work for a later period, and should be charged to the working costs of the following period. The cost of roads made over a property is also for a permanent improvement in most cases. In the case of a company growing a crop which cannot be harvested until after several years' cultivation, such as rubber, the whole of the cost of cultivation, until the trees are in bearing, is usually charged to the Property Account.

Buildings, if freehold, are shown at actual cost; but if leasehold, provision is generally made in respect of the loss owing to the shortening of the life of the lease. This may be either by charging to the Profit and Loss Account a proportion of the cost, and so diminishing the figure at which the lease stands in the books, or by the provision of a Redemption Fund, which with interest will amount at the expiry of the lease to the original cost. In this case it is usual for the Redemption Fund to appear amongst the liabilities, and the lease at its original cost.

Plant and Machinery, in the case of a manufacturing concern, is an item of some magnitude, and provision ought to be made to cover the loss by reason of wear and tear, and, where necessary, to provide for approaching obsolescence. As to what constitutes adequate provision depends entirely upon the nature of the machinery, and no general rules are of much value; but it may be stated that the life of a fast-moving machine is generally much shorter than that of a slow-moving one, and the more intricate a machine is the sooner does it depreciate.

Where a company has sunk any large amount of capital in the acquisition of patents, these will appear on the Balance Sheet at cost, but the fees on renewal should in all cases be charged to the Profit and Loss Account. It must be borne in mind, however, that a patent is only for a limited number of years, even if the renewal fees are duly paid; and therefore at the end of the time during which the patent is in force there will be no value in the patent as such, but only in any goodwill that may have been created during the life of the patent. If any patents have been allowed to lapse by non-payment of renewal fees, or non-fulfilment of the requirements of the Acts, the auditor will probably report such to be the case

Floating Assets

Floating Assets comprise all those items which are intended to be converted into cash, or are actually cash. It is not necessary that they should be immediately convertible into cash, but they will be as and when opportunity affords. Included under this heading there will be, in addition to the actual cash, Book Debts, Stock-in-trade, Temporary Investments, Bills Receivable, and usually Loose Tools and Stores. It will be seen that with the exception of Loose Tools and Stores the items would be without value unless they were capable of conversion into cash, although the terms of credit must expire before book debts can be collected, partly manufactured stock must be completed before being sold, &c.

It is important to notice that any losses in the floating assets must be made good out of revenue before any profits can be distributed, and accordingly all such items must be shown in the Balance Sheet at a figure not exceeding their true value to that business at that time. It follows, therefore, that if they appear in the books at a figure higher than their true value this loss must be written off before arriving at the profits. On the other hand, any accretion in value above the figure standing in the books cannot with safety be brought into account until the item has been actually realized.

The item of Cash hardly calls for comment. It includes balances at bank whether on deposit or current accounts, cash in hand and petty cash, but is not considered to include balances in the hands of third parties other than bankers.

The item of Sundry Debtors should only include the debts that are actually recoverable; all debts known to be bad should be written off and a sufficient reserve made for doubtful debts. It is usual to deduct from the amount of the Sundry Debtors an amount estimated to cover the discount that has to be allowed if payment is made within the proper time. It is sometimes argued that this discount has not to be deducted, because it may not have to be allowed; but this is not a sound position, because the company holds itself out to allow the discount to its customers, and therefore the option is not with the company.

Stock-in-trade

The item Stock-in-trade is one that requires the most careful attention. In the first place, it is impossible to prepare the Profit and Loss Account of a trading concern that carries any stock without a valuation thereof, and any error in this valuation is immediately reflected by a

corresponding error in the profit shown: an overvaluation causing the profit to be higher than it really is, and an undervaluation having the opposite effect. In the second place, the auditor of a company is not supposed to be in a position to know whether the stock has been taken at a fair valuation, and has no legal responsibility for the valuation unless his suspicion should have been aroused. It is, therefore, of the greatest importance that a correct basis should be taken for the valuation of the stock, and it is usual to indicate in the Balance Sheet what basis has been adopted, or the auditor in his report to the shareholders will state whose valuation has been accepted.

As a basis, it is evident that if the true value of the stock is to be shown, all unsaleable or bad stock should be written down to a proper figure. Unfortunately this is not always done, and many a concern has come to grief owing to an accumulation of unsaleable stock which still appears in the books at its original value. Those responsible for the valuation of stock should promptly deal with any unsaleable lines by writing them down to a low figure in the stock sheets.

It is evident, also, that the true value will not be the selling price, for until a sale has been effected this price includes the profit that has not been earned, and profit that has not been realized cannot be included amongst the assets. The cost price also may not be the true value, because goods may have been bought at a higher price than they are worth at the date when they are to be valued. A good general rule is to value the stock either at cost price or the lowest market price at the date of valuation, whichever is the lower. This will cover any loss in value that may have occurred up to the date of the Balance Sheet, and does not include any unearned profit. This rule, however, will not apply to all cases, and a few such may be mentioned.

Take the example of a factor of cheeses. Cheese is an article having a definite market value, and at stocktaking there may be included cheeses all of one brand which have been bought at varying dates and equally varying prices. It would be impossible to state the cost price of each cheese, but being all of the same brand they have the same value. The market price of the day at which they could have been bought and sold is readily available, and it is usual to value them at that price, or, if there are two prices, the mean between them. This will give quite fair results, for the value placed upon the cheese is, if anything, lower than the actual cost of purchasing on that day.

Similar considerations affect all businesses dealing in a commodity having a quoted market price, but which it is not possible to earmark with the cost price, such as metal merchants, stockjobbers, &c.

Another case in which the general rule does not apply, is that of a business growing a crop for sale when the sale cannot be effected in the same year as that in which the crop was grown, such as rubber or tea companies. The cost of such a crop is represented by the whole of the debit side of the Profit and Loss Account, for if the company is solely engaged in producing the crop there is nothing else to which the expenses can be charged.

If the whole of the crop is unsold at the end of the year, and is valued at the cost price, there will be no profit or loss shown; and if partially sold, only imperfect results will be shown. The practice has, therefore, arisen to wait until the whole of the crop has been sold before preparing the Balance Sheet, and then the crop on hand at the end of the year is valued at the net price it actually realized in the following year after charging all expenses of realization. By this means the Profit and Loss Account will show the result of the growth and sale of a definite crop rather than the result of trading for a particular period, and the Balance Sheet likewise shows the position at the date thereof, subject to the completion of the trading.

Temporary Investments

Where a company is in possession of cash for which it has no immediate use, it is usual to place such money at interest, either by way of loans at short notice on the Stock Exchange or elsewhere, or in marketable securities. Should there be any known loss at the date of the Balance Sheet in respect to any temporary investments, this loss must be provided for, because it is intended to convert them into cash when money is required. On the other hand, any appreciation in value is not, as a rule, taken into account until sale: the increase in value is not definite, and may never be realized. If the temporary investments consist of loans, it should be disclosed whether or not there is any security. If they consist of marketable securities, it may not be advisable to disclose the cost price of each investment, but it is a good practice to show the face value of each investment and then show the book value of the whole of them in one sum.

If any investments are held which are not intended for early realization, it is not usual to take into account any variation in the market price, unless the diminution in value is serious, when

the market value should be stated if the loss is not provided for.

Bills Receivable

Bills Receivable that have not matured at the date of a Balance Sheet should appear under this heading, and this requires no comment, except where the bills have been discounted. If any bills have been so dealt with, they will no longer appear amongst the assets, because the money received on discounting, with the discount charges, will have extinguished the amount of the bill; but this may not be the end of the transaction. Should a bill that has been discounted be dishonoured on the due date, the party who has discounted it will call upon the company to repay him, leaving the company to obtain payment from the party who gave the bill. There is therefore a contingent liability in respect to any bills which have not matured at the date of the Balance Sheet but have been discounted. This may be disclosed by a note on the Balance Sheet, such as "There is a contingent liability in respect to bills discounted of £——", or as follows:

Bills Receivable	... £6000	
Less Under Discount ...	... 3000	
		£3000

Intangible Assets

These have no material existence, but their value to a concern is represented by some benefit or advantage that is being enjoyed in the present time. It is often true that it is impossible to realize them (although Goodwill is a marketable commodity), but their value to the particular business at the particular time is quite a real one. Included under this heading are such items as Goodwill, and Development Expenses, and Advance Expenditure.

Goodwill and Development

The item of Goodwill in a Balance Sheet is often assumed to be of itself unsatisfactory unless there is a reserve provided out of profits with which to extinguish it. This presumes that it is of practically no value; but there is good reason for taking the opposite view. It is admitted that in the event of liquidation the value of goodwill often vanishes, but this test does not constitute sufficient grounds for assuming it to be valueless to a going concern. If it were, assets of a tangible nature would often fail at the same test. For example, plant and machinery will cost a great deal to install ready for work, but to sell would realize very little more than scrap price. On the other hand, a business having an established connection and reputation has a much greater value than a new business with equal capacity but without connection and reputation. In fact, in the case of retail businesses there is a marketable value in a goodwill based merely upon the turnover, quite irrespective of profit, which is daily bought and sold. This value is based on the expenses attaching to commencing and working up a business; and if such expenditure has achieved its end by placing the business on a profit-earning foundation, it is not a loss that should be written off out of Revenue, but an expenditure of Capital once and for all without which the business would have been unable to earn profits.

In the case of a business formed to exploit a definite article, for which it has to create a demand by advertising, &c., or which may need a deal of preparatory work before it can be placed on the market, this expenditure will appear under some such heading as Development Account.

The test of the value of goodwill and development is entirely a question of results. If the business is earning profits reasonably proportionate to the capital sunk in it (a part of which capital has been expended on this item) the value is justified; but if insufficient or no profit is being earned, then the item stands condemned.

Advance Expenditure

At whatever date a Balance Sheet is prepared, it rarely happens that payment for such items as Rates, Insurance, Telephone, &c., which are paid in advance, will have expired at the same date. The unexpired portions of such expenditure are calculated and shown under this heading as an asset. In most cases nothing could be recovered in respect of the amount unexpired, but the benefit of such will be reaped in the following period. In that way the asset that is shown on the Balance Sheet is duly realized.

An extension of this practice will be noticed in the Balance Sheets of companies producing a crop such as tea, rubber, or tobacco, which requires more than one year for its growth and sale. In the case of tea and rubber companies, the expenditure in any one year may include large sums in respect of manuring, procuring labour, work done or goods supplied and used, the benefit of which will not be reaped until the following season. The case of a tobacco-growing company is still more complicated, and it is sufficiently interesting to consider the following condensed Balance Sheet

of such a company, which was prepared as at 31 December, 1911.

Capital Issued.....	£78,329	Property A/c.....	£64,015
Creditors.....	32,042	Stores, &c.	876
Profit and Loss A/c	2,220	Tobacco Crops:	
		1911... £20,610	
		1912... 3,673	
		1913... 191	
			24,474
		Debtors.....	3,036
		Cash	10,711
		Preliminary Expenses.....	9,479
	£112,591		£112,591

It will be observed that the Advance Expenditure under the heading of Tobacco Crop amounts to no less than £24,474 out of a total of £112,591. The reason for this is that it takes four years to complete the growth and dispatch of a crop of tobacco. In the first year, work of a preliminary nature is done in the way of preparing the soil, &c. The crop will be sown the next year, harvested the following year, and finished and dispatched in the fourth year. The expenditure in any one year will therefore be divided into the following heads:—

(*a*) Cost of finishing and dispatching the crop harvested the previous year (a comparatively small amount).

(*b*) Expenditure on the cultivation and harvesting of the crop sown the previous year.

(*c*) Expenditure on sowing a crop which will not be harvested until the following year.

(*d*) Expenditure on preparatory work for a crop to be sown the next year.

In order to find what profit or loss has resulted from any crop, it is necessary to wait until it has been realized, i.e. the fourth year. It follows, therefore, that for the first three years the expenditure on the crop must be held up in the Balance Sheet, and in the fourth year this expenditure, together with that of the fourth year, will be charged to the Profit and Loss Account, which will be credited with the sale of the crop. This procedure will be adopted in each succeeding year, and in the Balance Sheet under consideration the item Tobacco Crop 1911, £20,610, corresponds to the division (*b*), Crop 1912 to (*c*), and Crop 1913 to (*d*). The expenditure under (*a*) has been charged in the Profit and Loss Account for the year.

Uncompleted Contracts

Another item coming under this division of a Balance Sheet is Profit on Uncompleted Contracts. This item occurs in the case of companies undertaking contracts. At the date when the accounts are prepared, it may happen that a large amount of work has been done upon a contract job for which part payment has been received. Until, however, the contract has been completed, and all the expenses in connection therewith incurred, it is impossible to arrive at the actual amount of profit earned. Under such circumstances it is usual to include amongst the assets an estimate of the profits that have been earned upon the portion of the work that has been done. It will be noticed that this is quite a different thing to taking as an asset an unrealized profit, for the profit has actually been earned, but the exact amount is unknown. This, of course, assumes that the estimate has been fairly made, erring on the side of under, rather than over, estimate. It is impossible to test the accuracy of the estimate except by way of a comparison with the average profits earned upon similar contracts, and the amount will usually be certified by a responsible official. The item will usually be shown in something like the following form:—

Work done on Uncompleted Contracts	£5000	0	0
Estimated Profit thereon	250	0	0
	£5250	0	0

Fictitious Assets

This is a contradiction in terms, and is represented by expenditure incurred which has not been written off to Revenue Account, but which has no present value. All such items have to be eliminated from any estimate of the assets of a concern, and it is therefore important to recognize them.

The most common items coming under this heading are as follows: Preliminary Expenses, Debenture Issue Expenses, Discount on Debentures, Special Expenses such as Repairs spread over a period of years, Expenditure Account in the case of a Company not earning Revenue, and the Debit Balance on Profit and Loss Account.

Preliminary Expenses are the costs incurred prior to and during the formation of a company, including the legal charges, &c. While there is no doubt that the actual expense of registering the company is essential before it can exist and earn revenue, and may therefore be justly considered as an expense of which the benefit is still being reaped, this usually forms a very small portion of the total expenditure, which does not represent any existing value. Should any commissions have been paid on shares, they must, by the requirements of the Companies (Consolidation) Act, 1908, be stated separately on every Balance

Sheet until written off; and as the wording is "any payments *by way of* Commission", Brokerage on Shares must be included with Commissions. It is usual to write off the Preliminary Expenses over a period of years, and such an item should not appear on the Balance Sheet of a successful company more than five years old.

"Debenture Issue Expenses" is similar to the foregoing, but represents the cost of issuing debentures, and should likewise be written off over a short period of years.

"Discount on Debentures" has already been referred to under the consideration of debentures.

"Special Expenses."—If any special expenses have been incurred during the financial year which were not incidental to the actual trading, and not in the nature of Additions or Improvements, it is not unusual, should such expenses be of a considerable amount, to spread the cost over a period of years. If this is done, there will appear upon the Balance Sheet such portion of the expenditure as has not been written off, although there is no asset represented by it. There is one case of this description where the expenditure is, on the face of it, an ordinary charge against Revenue which custom has allowed to be treated in this manner, that is Ships' Survey Expenses (see Part V). When it is necessary for a ship to be surveyed by Lloyd's Agents, the ship goes into dry dock and the surveyor decides what repairs are necessary in order to bring the ship into a proper condition. The cost of complying with his requirements is very heavy, but the value of the ship is not increased, for only necessary repairs have been executed. In the ordinary way these repairs should be written off to Revenue in the year in which they were done, but it is a general custom to spread the cost over three years, and so avoid charging one year's accounts with heavy survey expenses which are only incurred every four years.

"Expenditure Account" is an item which appears in the Balance Sheet of a company which has been formed for a certain purpose but which at the date of the same has not been in a position to earn revenue. An instance of this will be found in the case of a company which has been formed to acquire and work certain patents. For this purpose it may be necessary to build and equip a factory and carry out a great deal of experimental work before it can work the patent. During this period, in addition to the actual cost of the factory and experiments, considerable sums will be spent in the way of directors' fees, secretary, office expenses, and so on, while there have been no receipts on revenue account except transfer fees or interest on deposits, &c. Until the company is in a position to commence trading, all expenses are out of capital, and therefore there can be no Revenue Account; accordingly all the expenditure that is incurred must appear amongst the assets on the Balance Sheet, although there is no asset representing this item. When the company commences to trade, this account has to be dealt with. Prudent directors will usually decide to extinguish it out of the profits over a series of years, but it is sometimes transferred to a Goodwill Account, in which case it will appear permanently amongst the assets.

Profit and Loss Account

If there is a debit balance on this account, it will appear amongst the assets. This debit balance is the excess of expenditure over income, and shows that losses have been incurred which are not balanced by profits accumulated before, or afterwards earned. There is therefore an excess of liabilities over assets by this amount, and until this has been extinguished by subsequent profits there can be no profits available for distribution by way of dividends.

CONTINGENT LIABILITIES

If a company has entered into agreements or made arrangements which involve no liability at the date of the Balance Sheet, but which may do so at a date over which the company has no control, these contingent liabilities should be disclosed in order that the true position may be ascertained. It is not usual, however, to refer to such contingent liabilities as exist in the case of goods ordered for the usual course of trade but undelivered, unless these are of considerable extent; but if a large amount is involved, then it should be stated by way of a note.

If investments have been made in partly paid-up shares of another company, the amount of calls not made is a contingent liability which must be stated, for while there is no actual liability until the calls are made, the company has accepted the shares and agreed to pay the full amount when called upon to do so. In this case a note is usually added to the item of investments, saying that there is a contingent liability of £—— in respect to calls not made.

If any Bills Receivable have been discounted and have not matured at the date of the Balance Sheet

there is a contingent liability, as bills may be dishonoured at due date. Reference has already been made to this.

In the case of insurance companies there will always be claims made in respect to the period covered by the accounts which are unknown at the date of the Balance Sheet; and while it may occasionally appear as a note that there are contingent liabilities in respect to unexpired policies, the matter is more usually dealt with by creating reserves to cover these liabilities.

If in order to obtain loans from bankers or others security has been given, it is not sufficient to show on one side the liability in respect to the loan, and on the other side the value of whatever investments, &c., have been pledged without disclosing this fact, for while the actual liability on the loan is shown under certain circumstances, the security itself may be taken to satisfy this liability. It is necessary, therefore, to mention in the Balance Sheet what investments or other assets have been pledged.

PRIVATE FIRMS' BALANCE SHEETS

The Balance Sheet of a partnership or of an individual differs from that of a limited company mainly in the substitution of the partners' accounts for the Capital Account. There is also usually no balance of the Profit and Loss Account, any such balance being transferred to the partners' accounts according to the terms of division of profits; neither does the question of debentures arise.

It is important that all the accounts of each partner should be brought together, so that the Balance Sheet should show the exact amount of capital each partner has; for any drawings shown in a Drawing Account reduce his capital, and so do any items of goods supplied to him. On the other hand, any advances made by a partner to his firm, while they may be loans as between the partners, will form part of the capital as far as the ordinary creditors are concerned.

PREPARATION BY SINGLE ENTRY

This involves a method entirely different from that of accounts kept by double entry. It may perhaps be mentioned that very few concerns rely upon a true single-entry system of bookkeeping, but, on the other hand, the system used is often so incomplete that a Balance Sheet cannot be prepared on the ordinary basis, and therefore the method employed has to be that of single entry.

The principle consists in compiling a Statement of Assets and Liabilities, the excess of the former over the latter forming the capital, or if the liabilities exceed the assets, the deficiency of capital. If the amount of capital at a previous date is known, the increase of capital at the later date represents the profit, or the decrease represents the loss, subject of course to any adjustment necessary by reason of further capital introduced or amounts withdrawn.

The actual preparation of the Statement is often difficult, as the information required is not always given in the books. The fixed assets will probably be shown in the previous Balance Sheet, and any expenditure in the nature of additions must be taken into account; or if there is not this information, it will be necessary to value them. The stocks and stores of loose tools, &c., will be valued in the usual way.

The list of debtors, if a proper Ledger is kept and the payments have been posted from a Cash Book, is not difficult; but a true single-entry system has no Cash Book, and the Ledger will only show the amounts charged to customers, and when paid the entry is simply crossed through, either with or without the date of payment. If the date of payment is shown, a list can be prepared; but if not, the list must be prepared on the actual day which is to be the date of the Balance Sheet.

The cash also may present some difficulty unless a proper Cash Book is kept. Where there is no proper Cash Book it may be necessary to arrive at the balance from the Passbook, and this requires adjustment by reason of outstanding cheques.

The Statement of Liabilities presents the most difficulty as a rule, as it is very unusual for an imperfect system of bookkeeping to show in the books the amounts owing, whether for goods purchased or expenses incurred. It will be necessary, therefore, to examine all unpaid invoices and statements, and all such as have been paid since the date of the Balance Sheet that has to be prepared. If any are missing there is no information available to correct this.

It is because of these inabilities to check the omission of assets or liabilities that single-entry is so unsatisfactory. Errors are so liable to enter into the Balance Sheet, which is, therefore, quite unreliable and sometimes most misleading. All commercial books should be properly kept by double entry.

CHAPTER V

ACCOUNTS OF LIMITED COMPANIES

Introductory—Various Classes of Shares—Issued Capital—Share Capital Accounts—Transfers of Shares, &c.—Goodwill—Issue of Shares at a Premium—Dividends—Preliminary Expenses—Debentures—Increase and Decrease of Capital.

INTRODUCTORY

The accounts of the trading of limited companies are kept on exactly the same basis and in the same form as those of private firms. There is only one respect—a very important one—in which the accounts require to be treated differently from those of trading concerns conducted by individuals or firms, viz., their Capital Accounts. The necessity for the special treatment of the Capital Account arises in large measure from the fact that there is frequently a very large number of proprietors, each of whom must have a separate account of his own, as in the case of an ordinary partnership, and it would not be possible to record these in the usual private ledger of the company, especially having regard to the fact that the membership is constantly changing, owing to members of the company disposing of their interests to others. A further reason for the special treatment is the different nature of the relationship existing between the members of a company and that of the members of a firm.

The nature of the constitution of a joint-stock company has already been explained in Part III, Chapter IV. The only kind of limited company with which it is proposed to deal from the point of view of accounts is the company limited by shares. Companies limited by guarantee only require no Capital Account, as nothing in the nature of capital is contributed by the members unless the company is wound up. Unlimited companies' Capital Accounts are the same as in ordinary partnerships, but very few companies of this kind are registered. There is no difference between the accounts of public and private companies limited by shares, so that the following explanations may be taken as applying equally to both so far as the accounts are concerned.

It has already been seen that the capital of companies limited by shares is divided into a number of parts called shares, each bearing a distinctive number and being of a fixed nominal amount which the company is entitled to receive, not necessarily at once, in consideration of having issued the share. The extent to which the company may issue shares is limited when the company is registered, and is known as the Nominal Capital. This is generally referred to in the published accounts as the "Authorized Capital". No investment in its capital may be received by the company beyond the amount so fixed, unless the proper steps have been taken to increase the nominal capital.

VARIOUS CLASSES OF SHARES

(The various classes of shares have been explained in Part III, Chapter IV.)

Where the shares are all of one class, entitling the holders to equal rights as to capital, and participation in profits, they are termed Ordinary shares. Frequently, however, there are two classes, one having a prior right to receive distributions of profits up to a fixed percentage on the amount

paid up on the shares. These are known as Preference shares, and they usually confer the further right on the holders to be repaid their capital in the event of winding-up, before the Ordinary shareholders receive anything. A further class of shares sometimes created, called Founders' shares, are usually either few in number or of small nominal value, and are usually issued to the promoters of a company. They rank behind the Preference and Ordinary shares as to both capital and profits, but are entitled to either a large proportion or all of the profits after a distribution, or dividend, at a fixed rate has been paid on the Ordinary shares.

An illustration of the manner in which Founders' shares benefit, in the event of large profits being earned, will show why the founders or promoters of companies keep them in their own hands. It is to be observed that the nominal value being small there is little to lose and the possibility of considerable gain.

The Central African Rubber Company, Limited, had a capital of £20,100, divided into 10,000 6 per cent Preference and 10,000 Ordinary shares of £1 each, and 2000 Founders' shares of 1s. each. The company made a profit during its first year of £3000, out of which the Preference shares were entitled under the Articles to 6 per cent dividend and the Ordinary shares to 10 per cent, the Founders' shares being entitled to the balance of the profits. The distribution of the profits would be as follows:—

10,000 Preference shares at 6 per cent	£600	
10,000 Ordinary shares at 10 per cent	1000	
		£1600
Leaving for the Founders' shares ...		1400 or 1400%
		£3000

This might seem an exaggerated example, but it may be mentioned that one of the chief London stores has distributed over 5000 per cent on its Founders' shares in one year after paying large dividends on its Ordinary shares and carrying a considerable sum to reserve.

ISSUED CAPITAL

The Nominal Capital of a limited company does not necessarily or even frequently appear in a company's books of account. In fact, unless all the Nominal Capital has been paid to the company, it does not figure as an item in the accounts, although it is always stated as a memorandum in the Balance Sheet. The accounts are only concerned, firstly, with the amount of capital the company has actually issued, which is known as the subscribed or issued capital; secondly, with the amount the shareholders have been called upon to pay on the issued shares, which is termed the Called-up Capital; and thirdly, with the sum actually received from the shareholders, which is called the Paid-up Capital and is the amount which is finally brought into the Balance Sheet as the company's liability to its proprietors on Capital Account.

The usual method by which a company of any considerable size effects the issue of its capital is to publish a document known as a prospectus, inviting subscriptions for shares. It must be remembered that only public companies may issue an invitation to the public to apply for shares. The nature of a prospectus and the requirements of the law with regard to its contents are dealt with in Part III, Chapter IV, and it is sufficient to say here that it should give such information as will enable members of the public to form an opinion whether or not to invest in the company. The class and number of shares offered for subscription are stated, and the method in which they will have to be paid for. This is commonly by a deposit being made at the time of application for the shares, a further instalment if and when the application is granted, i.e. when the shares are allotted, and the balance at such intervals as are named in the prospectus. Sometimes the whole amount is not required at once, a balance being left to be called up by the directors as required.

Application and Allotment

A form of application is enclosed in the prospectus (or attached to the advertisement in the press) which must be filled in by persons desirous of obtaining shares in the company. The following is a specimen of an application for shares in the usual form:—

SAFE INVESTMENTS, LIMITED

CAPITAL - - - £40,000

DIVIDED INTO 40,000 SHARES OF £1 EACH

Form of Application for Shares

To the Directors of

SAFE INVESTMENTS, LIMITED.

Gentlemen,

Having paid to the bankers of the Company, the Universal Bank, Limited, the sum of £....., being a deposit of 2*s.* 6*d.* per share on application for ..... shares of £1 each in the above-named Company, I request you to allot to me that number of shares, and I hereby agree to accept the same or any less number that may be allotted to me, upon the terms and conditions contained in the Company's Prospectus, as filed with the Registrar of Joint Stock Companies, and the Memorandum and Articles of Association of the Company, and I further agree to pay the sum of 2*s.* 6*d.* per share on allotment, and the balance in calls as provided by such Prospectus, and authorize you to place my name upon the Register of Members in respect of the shares which may be allotted to me.

Name in full, ...

Address, ...

Description, ...

Ordinary Signature, ...

Date, ...

This form must be sent entire to the Company's bankers, The Universal Bank, Limited, 621 Lothbury, London, E.C., together with a cheque payable to the bankers, *or bearer*, for the amount of the deposit of 2*s.* 6*d.* per share on the shares applied for.

SAFE INVESTMENTS, LIMITED

Receipt for Payment upon Application

.... 1912.

Received from ....., on account of SAFE INVESTMENTS, LIMITED, the sum of ..... pounds, ... being a deposit of 2*s.* 6*d.* per share on application for ..... shares in the Company of £1 each.

For the Universal Bank, Limited,

£ : :

.....

Cashier.

This Receipt should be retained, to be exchanged (with other necessary documents) for the Share Certificate when ready, notice of which will be given.

The application form is sent by the applicant to the bankers, accompanied by a remittance for the amount named in the form. The bankers retain the money and place it to the credit of the company. The upper portion of the form is sent on by the bank to the secretary of the company, who makes a list of all the applications received. The list is used for making the entries in the statistical books of the company, which record the holdings of each shareholder, and is therefore somewhat elaborate in its ruling. The table on p. 162 is a specimen of such a form.

This list is considered by the directors at a meeting. Their first concern is to ascertain whether the minimum subscription (see Part III, Chapter IV) has been obtained. If it has, they may proceed to allotment. If the number of shares for which application has been made is the number for which subscriptions were invited, the allotment is a simple matter, each applicant being allotted the number he has applied for. If the issue is over-subscribed the directors have to consider whether to make a proportionate deduction from all applications, or what other course to take to apportion the shares amongst the applicants. In trading concerns appealing to large numbers of

No. of Application.	Name.	Address.	Description.	No. of Shares Applied for.	Application Money Paid. £	s.	d.	Cash Book Folio.	No. of Shares Allotted.	Share Ledger Folio.	Distinctive Numbers. From	To	Total Amount Due on Application and Allotment. £	s.	d.	Amount Returnable (if any)	Net Amount Due on Allotment. £	s.	d.	Amount Paid on Allotment. £	s.	d.	Cash Book Folio.	Amount of Call Due 15 June, 1912. £	s.	d.	Amount of Call Paid. £	s.	d.	Cash Book Folio.	Remarks.
126	Smith, John	1 High St., Oldcastle.	Draper	200	25	0	0	16	100	111	26,281	26,380	50	0	0	—	25	0	0	25	0	0	71	50	0	0	50	0	0	181	

the public it is generally advisable to make allotments to small applicants in full, thus interesting as large a number of people as possible in pushing the interests of the company. In financial concerns it may be considered more desirable to have the shares in as few hands as possible. These are points for the directors to consider, having regard to the character of the company. Whatever the method they adopt, the number of shares allotted will be the number for which applications were invited.

In cases where the minimum subscription has been applied for but the full number offered has not been subscribed, the directors are in a more difficult position. If, however, the issue has been underwritten they have merely to apportion amongst the underwriters the deficiency in the public applications. When the issue has not been underwritten the directors have to decide whether it is not the proper course to return the application money and abandon the flotation. It is because of the general reluctance to take this course, and so lose the benefit of the money already spent on the promotion, that many companies fail owing to going to allotment on insufficient subscriptions. No general rule can be laid down as to the course that should be taken. Each case must depend on circumstances, but directors incur a grave responsibility in going to allotment on a subscription which will not produce the capital which, before the issue of the prospectus, was considered necessary to put the company in a sound financial position. (See generally Part III, Chapter IV.)

As soon as the allotment has been made, notice thereof must be sent to each person to whom shares have been allotted. This is absolutely necessary, as, until such notice has been given, the applicants are at liberty to withdraw their applications and receive the return of their deposits. This is the essential difference between the position of the shareholders of a limited company, who are the proprietors of its business, and an individual who carries on a business of his own. The latter is under no obligation to invest any particular sum in his undertaking, or, indeed, anything at all. But in the case of a shareholder there is a legal contract on his part to pay to the company the full nominal amount of his shares. His application for shares is the offer, and the notice of allotment is the company's acceptance. The shareholder is, of course, in a better position than the private trader, in that he is only liable for the nominal amount of his shares whatever may be the result of the company's trading or the magnitude of its liabilities; while the sole trader is liable to lose not only what he has invested in his business in the way of capital, but also his

private estate if that is required to pay the liabilities of the business.

The notice to the shareholder is called a Letter of Allotment, and is in the following form:—

SAFE INVESTMENTS, LIMITED

Stamp.

Letter of Allotment

No. .....

654 Cornhill, London, E.C.,
June, 1912.

Dear Sir (or Madam),

I am instructed by the Directors of the above-named Company to inform you that in response to your application they have allotted to you ..... shares in the Company.

The total amount due upon application and allotment is ... ... £.....
You have already paid on application for ..... shares ... ...

Leaving a balance payable by you of ... ... £.....

which sum please pay to the Company's bankers, the Universal Bank, Limited, 621 Lothbury, E.C.

I am, Dear Sir (or Madam),
Your obedient Servant,

....
Secretary.

SAFE INVESTMENTS, LIMITED

Receipt for Payment upon Allotment

..... 1912.

Received from ....., on account of Safe Investments, Limited, the sum of ..... pounds, ... shillings and ..... pence due in respect of the above allotment.

For the Universal Bank Limited,

.....
Cashier.

The further sum named as payable should be forwarded by the Allottee with the Letter of Allotment to the bankers, who will return it to him with a receipt for the amount. He retains this with the receipt for the application money until such time as he is advised by the company that he may exchange them for a share certificate. The certificate is issued under the common seal of the company, and is to the effect that he is the registered holder of a certain number of shares bearing definite numbers, and that a stated amount has been paid on each share.

When no allotment is made to an applicant a "Letter of Regret" is sent to him informing him that the directors have been unable to allot him any shares in response to his application. A remittance for the amount he paid when applying for the shares is forwarded to him at the same time.

It is generally advisable, and in large issues it is practically essential, to enter the cash received on the application and allotment of shares in cash books specially kept for the purpose, and to transfer the daily totals only to the general cash book. This is a convenience for two reasons: it avoids the cumbering of the general cash book with numerous small items, and facilitates the posting of the amounts received to the individual accounts of the respective shareholders.

In addition to the entry in the subsidiary cash books of the cash received from shareholders, the columns on the allotment sheets must be filled in by the secretary as the amounts payable for allotment money and calls are received. The totals of the cash columns of the sheets must be agreed with the total amounts credited to the Application, Allotment, and Call Accounts in total in the Private Ledger.

SHARE CAPITAL ACCOUNTS

The entries to be made in the financial books in order to record the issue of the shares proceed on the same lines whatever the class of shares allotted. There must be separate accounts for each class of share capital, e.g. Ordinary Share Capital Account, Preference Share Capital Ac-

count, &c. As the shareholders are liable to pay to the company the amounts payable on their shares in accordance with the terms of the prospectus, they are debited in special books called Share Ledgers, and the respective Capital Accounts are credited in the Private Ledger with the sums payable.

In the financial books accounts representing the body of shareholders as a whole are debited with the total sums due from them in respect of application, allotment, and call moneys, the Share Capital Accounts being credited. This system of debiting the proprietors of the business with the capital they are to bring in is only possible because of the contracts into which they have entered to pay for their shares. The accounts through which the body of shareholders are thus debited with the amounts payable on application and allotment are sometimes combined in one account called the "Application and Allotment Account". In other cases there are two accounts. To illustrate the working of the system it will be well to take the example of an issue of capital of three classes of shares.

The Central African Rubber Company, Limited, issued a prospectus offering for subscription, at par, 10,000 six-per-cent Preference and 10,000 Ordinary shares at £1 each, payable 2*s.* 6*d.* per share on application, 7*s.* 6*d.* per share on allotment, and 10*s.* per share one month after allotment. Two thousand Founders' shares of 1*s.* each were paid for and allotted to various persons on the same day as the Preference and Ordinary shares. The following would be the entries in the company's books of account recording the transactions, it being assumed that the issue was over-subscribed and that 10,000 each of Ordinary and Preference shares were allotted and duly paid for:—

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1912.				£	s.	d.	£	s.	d.
April	1	Ordinary Share Application Account	*Dr.*	1250	0	0			
		To Ordinary Share Capital Account					1250	0	0
		For deposit of 2*s.* 6*d.* per share payable on application for 10,000 shares.							
		Preference Share Application Account	*Dr.*	1250	0	0			
		To Preference Share Capital Account					1250	0	0
		For deposit of 2*s.* 6*d.* per share payable on application for 10,000 shares.							
		Ordinary Share Allotment Account	*Dr.*	3750	0	0			
		To Ordinary Share Capital Account					3750	0	0
		For 7*s.* 6*d.* per share payable on allotment of 10,000 Ordinary shares.							
		Preference Share Allotment Account	*Dr.*	3750	0	0			
		To Preference Share Capital Account					3750	0	0
		For 7*s.* 6*d.* per share payable on allotment of 10,000 shares.							
		Founders' Share Application and Allotment Account	*Dr.*	100	0	0			
		To Founders' Share Capital Account					100	0	0
		For amount payable on application and allotment of 2000 shares.							
April	1	Ordinary Share Application Account	*Dr.*	861	0	0			
		To Ordinary Share Allotment Account					861	0	0
		For excess amount paid on application by allottees.							
		Preference Share Application Account	*Dr.*	124	0	0			
		To Preference Share Allotment Account					124	0	0
		For excess amount paid on application by allottees.							
May	1	Ordinary Share Call Account	*Dr.*	5000	0	0			
		To Ordinary Share Capital Account					5000	0	0
		For 10*s.* per share payable on 10,000 shares one month after allotment.							
		Preference Share Call Account	*Dr.*	5000	0	0			
		To Preference Share Capital Account					5000	0	0
		For 10*s.* per share payable on 10,000 shares one month after allotment.							

CASH BOOK

1912.			£	s.	d.	1912.			£	s.	d.
Apr.	1	To Ordinary Share Application Account..... (being the amount received on applications for 23,720 shares).	2,965	0	0	Apr.	15	By Ordinary Share Application Account..... (being amount returned on shares not allotted).	854	0	0
		To Preference Share Application Account ..... (being amount received on applications for 11,096 shares).	1,387	0	0			By Preference Shares Application Account..... (being amount returned on shares not allotted).	13	0	0
"	10	To Ordinary Share Allotment Account ..... (being amount received on allotment of 10,000 shares).	2,889	0	0			By Balance carried down...	20,100	0	0
		To Preference Share Allotment Account..... (being amount received on allotment of 10,000 shares).	3,626	0	0						
		To Founders' Share Application and Allotment Account.....	100	0	0						
May	10	" Ordinary Share Call Account.....	5,000	0	0						
		" Preference Share Call Account.....	5,000	0	0						
			20,967	0	0				20,967	0	0
		To Balance brought down...	20,100	0	0						

LEDGER

Ordinary Share Application Account

1912.			£	s.	d.	1912.			£	s.	d.
Apr.	1	To Ordinary Share Capital Account..... (Amount payable on 10,000 shares.)	1250	0	0	Apr.	1	By Cash received on Applications for 23,720 Shares...	2965	0	0
		To Transfer to Ordinary Share Allotment Account..... (Amount overpaid by persons who applied for a larger number of shares than were allotted to them, and appropriated for allotment.)	861	0	0						
"	15	To Cash..... (Amount returned to applicants who received no allotments.)	854	0	0						
			2965	0	0				2965	0	0

Ordinary Share Allotment Account

1912.			£	s.	d.	1912.			£	s.	d.
Apr.	1	To Ordinary Share Capital Account.....	3750	0	0	Apr.	10	By Cash received from Allottees of 10,000 Shares....	2889	0	0
								" Transfer from Application Account of excess amount paid by allottees on application	861	0	0
			3750	0	0				3750	0	0

Ordinary Share Call Account

1912.			£	s.	d.	1912.			£	s.	d.
May	1	To Ordinary Share Capital Account	5000	0	0	May	10	By Cash	5000	0	0
			5000	0	0				5000	0	0

Ordinary Share Capital Account

1912.			£	s.	d.
Apr.	1	By Ordinary Share Application Account	1250	0	0
		" Ordinary Share Allotment Account	3750	0	0
May	1	" Ordinary Share Call Account	5000	0	0

Preference Share Application Account

1912.			£	s.	d.	1912.			£	s.	d.
Apr.	1	To Preference Share Capital Account	1250	0	0	Apr.	1	By Cash received on Applications for 11,096 Shares	1387	0	0
		" Transfer to Preference Share Allotment Account of amount received on application in excess of the sum due on shares allotted	124	0	0						
"	15	" Cash returned to Applicants who received no Allotment	13	0	0						
			1387	0	0				1387	0	0

Preference Share Allotment Account

1912.			£	s.	d.	1912.			£	s.	d.
Apr.	1	To Preference Share Capital Account	3750	0	0	Apr.	10	By Cash received from the Allottees of 10,000 Shares	3626	0	0
								" Transfer from Preference Application Account of amount overpaid on application	124	0	0
			3750	0	0				3750	0	0

Preference Share Call Account

1912.			£	s.	d.	1912.			£	s.	d.
May	1	To Preference Share Capital Account	5000	0	0	May	10	By Cash	5000	0	0
			5000	0	0				5000	0	0

PREFERENCE SHARE CAPITAL ACCOUNT

			£	s.	d.
1912.					
Apr.	1	By Preference Share Application Account	1250	0	0
		" Preference Share Allotment Account	3750	0	0
May	1	" Preference Share Call Account	5000	0	0

The public applied for 23,720 Ordinary and 11,096 Preference shares. The directors made a proportionate allotment to most of the applicants, but declined some of them. The amounts of £854 and £13 shown by the Cash Book and the two Application Accounts as having been returned are the sums paid by the unsuccessful applicants. As the money paid on application by the allottees of 10,000 shares of each class was more than was required in respect of application the directors applied the excess towards the further amount payable on allotment. Hence the transfers from the two Application Accounts to the Allotment Accounts. The amounts payable by the allottees were thus reduced to the extent of the excess they had paid on application.

Register of Members

The accounts of the individual shareholders are kept in a book called the Register of Members and Share Ledger. Every company is required by law to keep a Register of Members, in which certain particulars have to be entered. (See Part III, Chapter IV.) It is convenient to combine this book with the cash accounts of the members in respect of their shares, and the following is a very usual form:—

REGISTER OF MEMBERS AND SHARE LEDGER

Name—Smith, John. *Date of becoming a Member*—1 April, 1912.
Address—1 High Street, Oldcastle. *Date of ceasing to be a Member* .....
Occupation—Draper.

Dr. CASH ACCOUNT *Cr.*

Date.		Particulars.	Amount per Share.	Amount Due. £	s.	d.	Date.		Particulars.	C.B. Fol.	Amount Paid. £	s.	d.
Apr.	1	To Application on 100 Shares	2/6	12	10	0	Mar.	31	By Cash on 200 Shares applied for	16	25	0	0
		" Allotment	7/6	37	10	0	Apr.	4	" Cash	71	25	0	0
May	1	" Call	10/	50	0	0	May	6	" Cash	181	50	0	0
				100	0	0					100	0	0

SHARE ACCOUNT

Shares Acquired.							Shares Disposed of.							Balances.	
Date.		Number of Allotment or Transfer.	Transferor's Folio.	Number of Shares.	Distinctive Numbers. From	To	Date.		Number of Transfer.	Transferee's Folio.	Number of Shares.	Distinctive Numbers. From	To	Date.	Number of Shares.
1912.							1912.								
Apr.	1	A 117	—	100	26,281	26,380	Sept.	18	65	236	50	26,281	26,330	18/9/12	50

TRANSFERS OF SHARES, ETC.

The particulars as to shares acquired are obtained in the first instance from the Application and Allotment Sheets, the cash paid by the shareholders being posted from the subsidiary Cash Books mentioned above. Particulars of shares acquired or disposed of after the original allotment are obtained from a book called the Register of Transfers, a specimen of which is shown on this page.

Shareholders are entitled, subject to the regulations of the company, to transfer their shares. This is done by means of a document known as a transfer deed, which is executed under seal and forwarded to the company with the share certificate for registration. (For the common form of deed see Part III, Chapter IV.) The transfer is laid before the directors for consideration, and if approved, effect is given to it by the shares being taken out of the name of the transferor and entered in the Register of Members and Share Ledger in an account in the name of the transferee. It is to be noticed that transfers of shares do not affect the Company's Share Capital Account in the financial books, as the shares transferred are not new shares in respect of which there is a fresh capital liability by the company, but are existing shares in respect of which the Share Capital Account has already been credited.

Calls on Shares

When the full nominal value of the shares is payable to the company under the terms of the prospectus within a short period, the form of application and allotment sheets on pages 161 and 162 give all the information required for completing the entries in the Share Ledger; but it not infrequently happens that only a portion of the face value of the shares is payable within a short time of allotment, the balance being left uncalled until required by the company. This is particularly the case with Banks, Insurance Companies, and large financial institutions generally, which desire to show a strong position, so far as meeting liabilities is concerned, by having a large reserve of capital which the shareholders can be called upon to pay up. Sometimes the Articles of Association provide that the uncalled capital shall only be enforceable in the event of liquidation. But in most cases the full amount of the shares is payable during the existence of the company as and when the directors decide it is required and call it up. Resolutions are passed by the directors, fixing the time and place of payment,

REGISTER OF TRANSFERS

Number of Transfer.	Date Lodged.	Date Passed by Board.	Transferor's			Shares Transferred.				Balance Certificate Number.	Transferee's				
			Name.	Address.	Folio in Share Ledger.	Number of Shares.	Distinctive Numbers. From	Distinctive Numbers. To	Amount Paid up. £ s. d.		Name.	Address.	Occupation.	Folio in Share Ledger.	New Certificate Number.
65	1912. Sept. 12	1912. Sept. 18	Smith, John	1 High St., Oldcastle.	62	50	26,281	26,330	50 0 0	416	Wall, Thos.	2 New St., Hightown.	Grocer	236	417

and notice is sent to each shareholder of the amount payable by him.

As each call is payable entries are made in the company's books similar to those shown above, except that the accounts to be debited with the total sums payable on each date will be First, Second, Third, &c., Call Accounts instead of Application and Allotment Accounts. The Share Capital Account is, however, credited in the same way as on the original issue with the full sums payable.

It is desirable to have subsidiary cash books to record the receipt of the sums paid by the shareholders in respect of the calls, the daily totals being carried into the general cash book. It is not necessary to have call sheets, although these are sometimes used, being ruled on the same lines as the application and allotment sheets as regards the sums payable. The accounts of the individual shareholders in the Share Ledgers are debited with the amount each has to pay and credited with the sums received as shown by the subsidiary cash books. It is usual to open separate banking accounts for each call, care being taken to pay amounts received into the correct account. Periodically the amounts to the credit of the several call accounts at the Bank will be transferred to the company's general account, and so be brought into the general funds of the company.

Forfeiture of Shares

Most companies have the right, under their Articles of Association, to forfeit the shares of any member in arrear on his shares. When this power is exercised the issued capital of the company as shown in the Capital Account is reduced to the extent of the amount called up on the shares, since they can no longer be treated as issued, and entries must be made to record this fact in the books. The Application, Allotment, and Call Accounts have been debited, and Share Capital Account credited, with the amounts payable on the shares. The Application, Allotment, and Call Accounts have also been credited with such sums as have been paid on these particular shares. As something remains unpaid, the balance outstanding appears as a debit on the respective accounts. The effect of the forfeiture is to deprive the shareholder of all interest in the shares and in the money paid to the company in respect of them. As the amount of the issued capital is decreased by reason of the forfeiture, the Share Capital Account must be reduced in the books correspondingly. Entries must also be made on the Allotment and Call Accounts extinguishing the debt owing by the shareholder whose shares have been forfeited. The money paid on the shares is retained by the company, and, as no liability on Capital Account or otherwise any longer exists, the amount may be regarded as a gain by the company.

Suppose a shareholder had been allotted 200 £1 shares and had paid 2*s.* 6*d.* per share on application, but nothing further, although the full amount was called up, and that the directors subsequently forfeited his shares; the entries to be made in the books would be:—

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				£	s.	d.	£	s.	d.
July	1	Ordinary Share Capital Account	*Dr.*	200	0	0			
		To Forfeited Shares Account					200	0	0
		For amount called up on 200 shares allotted to W. Green, forfeited by resolution of the Board, dated 30 June, 1912.							
		Forfeited Shares Account	*Dr.*	175	0	0			
		To Allotment Account					75	0	0
		" Call Account					100	0	0
		For amount unpaid on 200 shares in the name of W. Green.							

LEDGER

Dr. Ordinary Share Capital Account *Cr.*

1912			£	s.	d.	1912			£	s.	d.
July	1	To Forfeited Shares Account..	200	0	0	Apr.	1	By Application Account..... (2*s.* 6*d.* per share on 10,000 shares.)	1250	0	0
								" Allotment Account..... (7*s.* 6*d.* per share on 10,000 shares allotted.)	3750	0	0
						May	1	" Call Account..... (10*s.* per share on 10,000 shares.)	5000	0	0

ORDINARY SHARE APPLICATION ACCOUNT

1912.		£	s.	d.	1912.		£	s.	d.
Apr. 1	To Ordinary Share Capital Account	1250	0	0	Apr. 1	By Cash	1250	0	0

ORDINARY SHARE ALLOTMENT ACCOUNT

1912.		£	s.	d.	1912.		£	s.	d.
Apr. 1	To Ordinary Share Capital Account	3750	0	0	Apr. 10	By Cash	3675	0	0
					July 1	" Forfeited Shares Account	75	0	0
		3750	0	0			3750	0	0

ORDINARY SHARE CALL ACCOUNT

1912.		£	s.	d.	1912.		£	s.	d.
May 1	To Ordinary Share Capital Account	5000	0	0	May 10	By Cash	4900	0	0
					July 1	" Forfeited Shares Account	100	0	0
		5000	0	0			5000	0	0

FORFEITED SHARES ACCOUNT

1912.		£	s.	d.	1912.		£	s.	d.
July 1	To Allotment Account	75	0	0	July 1	By Ordinary Share Capital Account	200	0	0
	" Call Account	100	0	0					

It will be seen that the effect of these entries is to reduce the Ordinary Share Capital Account to the amount for which the company is now liable to its members in respect of capital, and to write off the balances due on the Allotment and Call Accounts. The credit of £25 remaining on the Forfeited Shares Account, representing the amount paid by the shareholder on the shares, will be included on the liabilities side of the Balance Sheet immediately under the Share Capital, but must not be added to it, as it is of a different nature.

The directors usually have power to reissue forfeited shares, and if they exercise it the Share Capital Account must be increased by the amount called up on the shares. They may issue them at a price below par, if in their opinion they are justified in doing so, subject to the condition that the total amount received by the company from the original holder and from the new allottee represents at least 20*s.* in the £ on the sum called up on the shares. If they can obtain par or more for them, they must, of course, do so in the interests of the company. Suppose the directors decide to reissue the above shares to A. Purchaser upon his agreeing to pay 18*s.* 9*d.* per share for them. The journal entries would be:—

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1912.		£	s.	d.	£	s.	d.
Aug. 1	A. PURCHASER ... ... *Dr.*	187	10	0			
	FORFEITED SHARES ACCOUNT ... ... *Dr.*	25	0	0			
	To Share Capital Account				200	0	0
	" Share Premium Account				12	10	0

These entries when posted to the Ledger will have the effect of closing the forfeited Shares Account and opening a new account to record the fact that the company has received a premium of £12, 10*s.* on the reissue of the shares.

Fully Paid-up Vendor Shares

It is not essential that shares issued by a company should be paid for in cash. They may be issued and regarded as fully paid up for other considerations, such as the sale of property to the company or services rendered. If shares are issued as fully paid for a consideration other than cash, a contract must be filed with the Registrar stating the consideration and the number of shares allotted. Shares are frequently issued in this manner when a company is formed to acquire the assets and take over the liabilities of an existing business at an agreed price. When this happens, a Balance Sheet of the business to be acquired is prepared as at the date from which the company is to take over. Suppose the business to be purchased is that of Messrs. Aye & Bee, whose Balance Sheet is as follows:—

BALANCE SHEET OF AYE & BEE AT 30 JUNE, 1912

	£	*s.*	*d.*		£	*s.*	*d.*
Creditors	4,500	0	0	Cash	500	0	0
Capital: Aye £7500 0 0				Debtors	3,000	0	0
Bee 4000 0 0				Stock	6,000	0	0
	11,500	0	0	Plant and Machinery	2,500	0	0
				Premises	4,000	0	0
	16,000	0	0		16,000	0	0

The price agreed to be paid by the company is £17,000, of which £5000 is to be paid in cash and £12,000 in Ordinary shares issued as fully paid. The company is registered under the name of Aye & Bee, Limited, with a nominal capital of £20,000 in £1 Ordinary shares, of which 8000 are subscribed and paid for in cash by the public. It is obvious that a considerable sum is being paid for goodwill, as the assets in the firm's Balance Sheet total only £16,000, against which the company is to discharge the liabilities amounting to £4500. The net value of the property which the company acquires is, therefore, £11,500 only. The difference between this sum and the purchase price of £17,000, viz. £5500, represents the price charged by the vendors for goodwill.

The entries necessary to record in the books the purchase of the business and the payment of the vendors will be as follows:—

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1912.				£	*s.*	*d.*	£	*s.*	*d.*
July	1	Cash	*Dr.*	500	0	0			
		Debtors (each debtor's account being separately debited)	"	3,000	0	0			
		Stock	"	6,000	0	0			
		Plant and Machinery	"	2,500	0	0			
		Premises	"	4,000	0	0			
		Goodwill	"	5,500	0	0			
		To Aye & Bee	"				21,500	0	0
		For the agreed price of the above assets acquired under agreement dated 25 June, 1912.							
		AYE & BEE	*Dr.*	4,500	0	0			
		To Sundry Creditors (shown in ledgers in detail)					4,500	0	0
		For liabilities taken over by the Company under the purchase contract							
		AYE & BEE	*Dr.*	12,000	0	0			
		To Ordinary Share Capital Account					12,000	0	0
		For 12,000 fully paid up £1 shares allotted to them by Board Minute dated 1 July, 1912, in part payment of the purchase price of their business.							
		APPLICATION AND ALLOTMENT ACCOUNT	*Dr.*	8,000	0	0			
		To Ordinary Share Capital Account					8,000	0	0
		For the amount payable on application and allotment for 8000 shares.							

CASH BOOK

1912.			£	s.	d.	1912.			£	s.	d.
July	1	To Aye & Bee	500	0	0	July	10	By Aye & Bee: Part payment of purchase price	5000	0	0
	10	" Application and Allotment Account	8000	0	0						

LEDGER

AYE & BEE (VENDORS' ACCOUNT)

1912.			£	s.	d.	1912.			£	s.	d.
July	1	To Sundry Creditors	4,500	0	0	July	1	By Cash	500	0	0
		" Balance c/d	17,000	0	0			" Debtors	3,000	0	0
								" Stock	6,000	0	0
								" Plant and Machinery	2,500	0	0
								" Premises	4,000	0	0
								" Goodwill	5,500	0	0
			21,500	0	0				21,500	0	0
July	1	To Share Capital Account	12,000	0	0			By Balance	17,000	0	0
"	10	" Cash	5,000	0	0						
			17,000	0	0				17,000	0	0

SUNDRY DEBTORS

1912.			£	s.	d.
July	1	To Aye & Bee	3000	0	0

STOCK

1912.			£	s.	d.
July	1	To Aye & Bee	6000	0	0

PLANT AND MACHINERY

1912.			£	s.	d.
July	1	To Aye & Bee	2500	0	0

PREMISES

1912.			£	s.	d.
July	1	To Aye & Bee	4000	0	0

GOODWILL

1912.			£	s.	d.
July	1	To Aye & Bee	5500	0	0

SUNDRY CREDITORS

			£	s.	d.
1912. July 1		By Aye & Bee	4500	0	0

SHARE CAPITAL ACCOUNT

			£	s.	d.
1912. July 1		By Application and Allotment Account	8,000	0	0
		" Aye & Bee	12,000	0	0

APPLICATION AND ALLOTMENT ACCOUNT

		£	s.	d.			£	s.	d.
1912. July 1	To Share Capital Account...	8000	0	0	1912. July 10	By Cash	8000	0	0

GOODWILL

The question of goodwill is one requiring the careful consideration of directors, who are frequently asked to pay very large sums in respect of this item, which, although often of considerable value, is of quite a different nature from the other assets. The general considerations with regard to Goodwill have been noticed in Part III, Chapter XVI. Goodwill is of value in the earning of revenue and profits, but has no cash value except upon a sale of the business or a portion of it.

An important factor in arriving at a fair price to pay for goodwill is the amount of the profits of the business being acquired. There are, of course, other considerations, such as the nature of the business and the time it has been established. The usual basis, however, upon which the price of this asset is fixed is a number of years' purchase of the profits—usually from two to five years'. In this connection directors may be warned not to accept a mere certificate that the average profits of a given period amount to a certain sum. They should insist on seeing a statement of the profits of each year of the period selected for the average, which should not be less than five years. The importance of this is that they may ascertain whether the profits have shown any considerable fluctuations and whether they are steadily declining or increasing. If a continual fall be shown, the directors should be on their guard against paying a high price for the goodwill, as the business in such a case is probably being formed into a company because the proprietors desire to get out of a failing undertaking. If the statement of profits shows considerable fluctuations, explanations should be obtained, as it may be that an exceptionally favourable year which has swelled the average is the result of circumstances which may never recur.

In the case of limited companies the acquisition of goodwill will practically always be in connection with a trading concern, so that the question whether the goodwill depends on the personality of the proprietor is not of such urgency as in the case of a professional man purchasing a business. The point must not, however, be overlooked, and should it appear that any future earnings will depend on the continued connection of the old proprietor with the business, provision for his services should be made. (See also Part I, Chapter I.)

Profits before Incorporation

The contract relating to the sale of a business to a company usually provides that the company shall take it over as from a stated date, up to which the profits will belong to the vendor and all outgoings be paid by him. After that date the benefit of the trading will belong to the company; and if, as usually happens, the completion of the purchase takes place some time later, the business is carried on in the meantime by the vendor on the company's behalf. The date from which the company takes over the business is frequently prior to the formation of the company. In such a case the company is not entitled to carry into its Profit and Loss Account for dis-

tribution amongst its shareholders the profit on the trading for the period between the date from which it takes over the business and the date from which it is entitled to commence business. The profits during this period must be capitalized, and may be treated as a reserve or applied to reduce the purchase price of the assets, goodwill being an appropriate item to which to transfer the amount. In the event of the trading during the period referred to resulting in a loss, there will be a debit balance to add to the cost of the property acquired.

ISSUE OF SHARES AT A PREMIUM

Although a company may issue shares for a consideration other than cash, they must not be issued at a discount whether the consideration received is cash or otherwise. Since the Companies Act, 1900, it has been permissible for a company to pay commission for the underwriting of its capital, but with this exception a company must receive in cash or other valuable consideration the full face value of every share it issues. It may, however, issue its shares at a premium if it is able to do so. This will not as a rule be the case with a new company unless it is taking over an established business at what is regarded as a low price. The issue of shares at a premium is generally made by companies which have for some time carried on business and distributed large dividends to their shareholders. In such cases, when further capital is required, it is obviously to the advantage of the company to obtain more than the face value of the shares it issues, for it has the use of the additional cash without having any corresponding liability to its shareholders on capital account, and thus has a smaller capital on which to pay dividends. When such an issue is made, the amount received by the company by way of premium is credited to a "Premium on Shares Account". The amount of premium payable is generally added to the sum due on either application or allotment. The method of dealing with the premium in the books of account will be seen from the following illustration: The General Utility Company, Limited, makes an issue of 20,000 Ordinary shares of £1 each at a premium of 10*s.* per share; applicants are to pay for the shares 5*s.* per share on application, 15*s.* on allotment (including the premium), and 10*s.* one month after allotment. The issue was fully subscribed. The Journal entries which would have to be made to record these facts would be as follows:—

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1912.				£	*s.*	*d.*	£	*s.*	*d.*
April	1	Application Account	*Dr.*	5,000	0	0			
		To Ordinary Share Capital Account					5,000	0	0
		Allotment Account...	*Dr.*	15,000	0	0			
		To Ordinary Share Capital Account					5,000	0	0
		" Ordinary Share Premium Account					10,000	0	0
May	1	Call Account	*Dr.*	10,000	0	0			
		To Ordinary Share Capital Account					10,000	0	0

Assuming that the company received all the cash payable on the shares, the accounts would appear in the Private Ledger as under:—

LEDGER

Application Account

1912.			£	*s.*	*d.*	1912.			£	*s.*	*d.*
Apr.	1	To Ordinary Share Capital Account	5000	0	0	Apr.	1	By Cash	5000	0	0

ALLOTMENT ACCOUNT

1912.			£	s.	d.	1912.			£	s.	d.
Apr.	1	To Ordinary Share Capital Account	5,000	0	0	Apr.	10	By Cash	15,000	0	0
		" Ordinary Share Premium Account	10,000	0	0						
			15,000	0	0				15,000	0	0

CALL ACCOUNT

1912.			£	s.	d.	1912.			£	s.	d.
May	1	To Ordinary Share Capital Account	10,000	0	0	May	10	By Cash	10,000	0	0

ORDINARY SHARE CAPITAL ACCOUNT

1912.			£	s.	d.
Apr.	1	By Application Account	5,000	0	0
		" Allotment Account	5,000	0	0
		" Call Account	10,000	0	0

ORDINARY SHARE PREMIUM ACCOUNT

1912.			£	s.	d.
Apr.	1	By Allotment Account	10,000	0	0

DIVIDENDS

The Profit and Loss Account of a company is prepared on the same principle as that of a single trader or a firm, but the balance, instead of being transferred to the Capital Accounts of the proprietors as in those cases, is carried to the credit of a "Profit and Loss Appropriation Account". That account is then debited with various items to record how the profit has been disposed of, e.g. the payment of dividends, creation of a Reserve, &c., and the balance is carried forward to the next period as shown below.

A company may only pay dividends to its shareholders of whatever class out of profits earned. It is not necessary to discuss here what are profits. When a dividend is declared by a company, a document called a dividend warrant is forwarded to each shareholder entitled to participate. It is in two parts, the first being a notification to the shareholder of the dividend declared, showing the amount to which he is entitled; while the second part is in the nature of a cheque, being an authority to the company's bankers to pay the amount due. Income Tax is always deducted by companies from dividends paid on Preference shares, and also on Ordinary shares unless the dividend on the latter is declared free of tax. The company, of course, pays tax on the full amount of its assessed profits. (See Chapter VIII of this Part.) The amounts thus deducted from the shareholders' dividends go in relief of the amount paid to the Revenue authorities.

In the books of account the amount of the dividend is debited to the Profit and Loss Appropriation Account and credited to a dividend account. The amount paid and the Tax deducted are debited to the dividend account, which is closed, as in the example shown on p. 176. It is the general practice to draw a cheque for the total amount payable to the shareholders in respect of each dividend, and to open a special banking account out of which the dividend warrants are paid.

PROFIT AND LOSS APPROPRIATION ACCOUNT

1912.			£	s.	d.	1912.			£	s.	d.
June	30	To Dividend on 40,000 5 per cent Preference Shares	2,000	0	0	June	30	By Net Profit for year b/d	11,156	4	6
		" Dividend at 10 per cent on 40,000 Ordinary Shares	4,000	0	0						
		" Reserve Fund Account	2,000	0	0						
		" Balance c/d	3,156	4	6						
			11,156	4	6				11,156	4	6
						July	1	By Balance b/d	3,156	4	6

PREFERENCE DIVIDEND ACCOUNT

1912.			£	s.	d.	1912.			£	s.	d.
Aug.	30	To Cash	1883	6	8	June	30	By Profit and Loss Appropriation Account	2000	0	0
		" Income-tax Account (1s. 2d. on £2000)	116	13	4						
			2000	0	0				2000	0	0

ORDINARY DIVIDEND ACCOUNT

1912.			£	s.	d.	1912			£	s.	d.
Aug.	30	To Cash	3766	13	4	June	30	By Profit and Loss Appropriation Account	4000	0	0
		" Income-tax Account (1s. 2d. on £4000)	233	6	8						
			4000	0	0				4000	0	0

INCOME-TAX ACCOUNT

1913.			£	s.	d.	1912.			£	s.	d.
Jan.	1	To Cash (1s. 2d. on £11,156, 4s. 6d.)	650	15	8	Aug.	30	By Preference Dividend Account	116	13	4
								" Ordinary Dividend Account	233	6	8

PRELIMINARY EXPENSES

Certain expenses are incurred in the formation of every company in connection with the registration. Fees are payable on filing the Memorandum and Articles of Association, and *ad valorem* duty is payable on the amount of the nominal capital (Part III, Chapter IV). In the event of a public issue of shares further expenses will be incurred in respect of printing and advertising the prospectus, postage, &c. Other expenses, such as underwriting commission, brokerage on shares, and legal charges, will also have to be paid before the company is in a position to commence business. All these charges are known generally as "Preliminary Expenses", and when they are payable by the company they are debited to a Preliminary Expenses account in the ledger. As the company may in a sense be regarded as benefiting from this outlay during the whole of its existence, the expenditure may be said to partake of the nature of capital expenditure, but as there is no realizable value attaching to it the amount is practically always written off during the early years. It is desirable to write it off against revenue over the first three years by charging an equal amount to the Profit and Loss Account during that period.

DEBENTURES

Considerable confusion exists in the minds of many people with regard to the nature of debentures and debenture stock. These forms of investment are frequently regarded as a superior class of share, but it cannot be too clearly stated that they are entirely different from shares with regard to priority both of principal and income. Shares represent the interests of the proprietors of the undertaking which issues the shares, while debentures represent loans advanced to the company by persons who, as a rule, are in an exceptionally favourable position as to repayment. The shareholders are in fact in the same position as to priorities as the owner of a private business, while debenture holders are, as a rule, in the position of mortgagees.

It is very seldom that debentures are issued which do not give the holders a charge or mortgage on the company's assets as security for repayment. When debentures do not contain such a charge they are no more than promissory notes and the holders are in the same position as ordinary trade creditors. The difference in character between debentures and shares is further emphasized by the fact that whereas shareholders may only receive dividends out of profits earned by the company, debenture holders are entitled to interest at an agreed rate whether the company earns profits or not. In fact, if the interest is not paid punctually they usually have the right to take possession of the company's property by means of the appointment of a Receiver, with power to sell the property for the purpose of paying the debenture holders their principal and interest.

The usual form of debenture issued by a company is known as a mortgage debenture, because it is in effect a mortgage on the company's assets. For full information as to the conditions under which debentures are issued, see Part III, Chapter IV; but it may be mentioned here that debentures may be issued either in consideration of cash advanced or fully paid up as consideration for property sold to the company.

In the case of a public issue of debentures for which subscriptions are invited, the entries to be made in the company's books are very similar to those made on the issue of shares. Forms of application are issued with the prospectus or other invitation to subscribe, as in the case of shares. The applications are sent direct to the company's bankers with remittances for the deposit, and a list of them is prepared upon which the directors make the allotment. The list is similar to that used for share allotments, sufficient money columns being provided for the instalments by which payment has to be made for the debentures.

Accounts are opened in the Private Ledger, entitled Debenture Application and Debenture Allotment Accounts, to represent in bulk the persons who have applied for and been allotted debentures. These accounts are debited in total with the sums payable on application and allotment, and a Debenture Account is credited with the amounts. Debentures are always paid up in full within a short period of the issue, and frequently all the money has to be paid on allotment. There is, therefore, no occasion to open Call Accounts as in the case of shares. The following Journal entries will afford sufficient information as to the methods adopted to bring the facts with regard to the debentures into the financial books:—

JOURNAL

1912.				£	s.	d.	£	s.	d.
April	1	Debenture Application Account	*Dr.*	10,000	0	0			
		To Debentures Account					10,000	0	0
		For deposit of 20 per cent payable on application for £50,000 debentures.							
April	8	Debenture Allotment Account	*Dr.*	40,000	0	0			
		To Debentures Account					40,000	0	0
		For balance of 80 per cent payable on allotment of £50,000 debentures.							

These entries are posted in the ordinary manner to accounts in the Private Ledger.

If the number of applicants is large, it is desirable to have subsidiary cash books to record the receipt of the debenture moneys, the daily totals only being entered in the general cash book, and posted from there to the Debenture Application and Allotment Accounts in the Ledger.

It will be necessary to keep a Register of the

debenture holders; but as debentures are, as stated above, always fully paid up within a short time of allotment, it is not necessary to include a cash account for each holder. The allotment sheets contain all the information required in connection with the amounts due and paid by the individual holders. The following form of register is all that is necessary:—

REGISTER OF DEBENTURE HOLDERS

Name—William Black. *Occupation*—Merchant.
Address—1 Low Road, Yorktown.

Debentures Acquired.						Debentures Transferred.						Balance.	
No. of Transfer or Allotment.	Date.	Transferor's Folio.	Amount Acquired.	Distinctive Numbers.		Number of Transfer.	Date.	Transferee's Folio.	Amount Transferred.	Distinctive Numbers.		Date.	Amount.
				From	To					From	To		
	1912.		£				1912.		£			1912.	£
65	Aug. 15	41	500	681	730	85	Oct. 18	93	250	681	706	18/10	250

This Register must not be confused with the Register of Mortgages which every company is required to keep. That is a book containing particulars of every charge of a certain character created by a company, while the Register shown above is a statistical book to be used when debentures are issued in a series to a considerable number of holders.

Debentures Issued at a Discount

Debentures are either redeemable, in which case the amount advanced to the company is repayable at a fixed date, or irredeemable, in which event the principal is only payable on default by the company on one or more of the conditions on which the debentures were issued.

Debentures, unlike shares, may be issued at a discount. This means that in the case of a redeemable debenture the company has to repay at the expiration of the loan, or earlier in the case of default, a larger sum than it has received. The result is the same when a company issues debentures at par which are repayable at a definite date at a premium. In either case the company suffers a loss which must be recorded in the books. In the case of an issue at a discount, an account is opened at the time of the issue entitled "Discount on Debentures Account" or some equally descriptive title, and debited with the amount of the discount. This discount is the amount which the company will lose eventually, but as the benefit of the loan is spread over a term of years the loss is not charged against the Profit and Loss Account of a single year, but is spread over the whole period, a proportion being debited in the accounts annually.

To illustrate the method adopted to deal with the discount in the books, let the case of a company be taken which has made an issue of £50,000 4½ per cent mortgage debentures at the price of 95, repayable at par in twenty-five years. The entries made in the books of account to deal with this position would be similar to those shown on p. 179.

By means of these entries the liability of the company to the debenture holders is shown at the full amount from the commencement, while the writing off of the discount on the issue is spread over the period during which the company has the use of the money.

When debentures are issued at par and are repayable at a premium, the entries to be made are similar in effect but slightly different in form. There is no immediate difference to record, but provision has to be made over the period of the loan for the larger sum the company will have to repay. The entries on the issue will be a debit

JOURNAL

				£	s.	d.	£	s.	d.
1912. Jan.	1	DEBENTURE APPLICATION AND ALLOTMENT ACCOUNT ...	*Dr.*	47,500	0	0			
		To Debentures Account					47,500	0	0
		For the amount payable on application and allotment for £50,000 debentures at 95.							
		DISCOUNT ON DEBENTURES ACCOUNT	*Dr.*	2,500	0	0			
		To Debentures Account					2,500	0	0
		For the amount of the discount on the issue of £50,000 debentures at 95.							
Dec.	31	PROFIT AND LOSS ACCOUNT	*Dr.*	100	0	0			
		To Discount on Debentures Account					100	0	0
		For the proportion of discount written off for the year, being one twenty-fifth of the total.							
1913. Dec.	31	PROFIT AND LOSS ACCOUNT	*Dr.*	100	0	0			
		To Discount on Debentures Account					100	0	0
		Further proportion written off for the year 1913.							

CASH BOOK

Dr. *Cr.*

			£	s.	d.						
1912. Jan.	1	To Debenture Application and Allotment Account	47,500	0	0						

LEDGER

DEBENTURE APPLICATION AND ALLOTMENT ACCOUNT

Dr. *Cr.*

			£	s.	d.				£	s.	d.
1912. Jan.	1	To Debentures Account...	47,500	0	0	1912. Jan.	1	By Cash.....	47,500		

DISCOUNT ON DEBENTURES ACCOUNT

			£	s.	d.				£	s.	d.
1912. Jan.	1	To Debentures Account...	2500	0	0	1912. Dec.	31	By Profit and Loss Account.....	100	0	0
								„ Balance c/d.....	2400	0	0
			2500	0	0				2500	0	0
1913. Jan.	1	To Balance b/d.....	2400	0	0	1913. Dec.	31	By Profit and Loss Account.....	100	0	0

DEBENTURES ACCOUNT

						£	s.	d.
			1912. Jan.	1	By Debenture Application and Allotment Account.....	47,500	0	0
					„ Discount on Debentures Account.....	2,500	0	0

to the Debenture Application and Allotment Account and a credit to Debentures Account of the par value payable by the allottees. The Application and Allotment accounts will be closed as usual by being credited with the amount received as shown by the Cash Book. At the end of the first year the following entry will be made in the Journal:—

1912.				£	s.	d.	£	s.	d.
Dec.	31	Profit and Loss Account	Dr.	100	0	0			
		To Premium on Debentures Account ...					100	0	0

This will be posted to the accounts named, and the process continued until the date when the debentures are repayable, by which time the credits on the Premium Account will amount to £2500, the sum payable to the debenture holders in addition to the amount they paid on the issue. This amount is then transferred to the credit of the Debentures Account, which will thus show at the date of repayment the actual sum due to the debenture holders.

Debentures Issued at a Premium

Debentures may be issued at a premium and made repayable at par, in which event the company makes a profit of the amount by which the cash received exceeds the face value of the debentures. The entries necessary in this event are as under:—

JOURNAL

1912.				£	s.	d.	£	s.	d.
July	1	Debenture Application and Allotment Account	Dr.	52,500	0	0			
		To Debentures Account					50,000	0	0
		" Premium on Debentures Account					2,500	0	0
		Being the amount payable on application and allotment for £50,000 debentures at 105.							

Dr. CASH BOOK *Cr.*

1912.			£	s.	d.					£	s.	d.
July	10	To Debenture Application and Allotment Account ..... (being the amount received, including £2500 premium).	52,500	0	0							

LEDGER

Dr. Debenture Application and Allotment Account *Cr.*

1912.			£	s.	d.	1912.			£	s.	d.
July	1	To Debentures Account (face value).....	50,000	0	0	July	10	By Cash	52,500	0	0
		" Premium on Debentures Account.....	2,500	0	0						
			52,500	0	0				52,500	0	0

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DEBENTURES ACCOUNT

			£	s.	d.
1912. July 1		By Debenture Application and Allotment Account	50,000	0	0

PREMIUM ON DEBENTURES

			£	s.	d.
1912. July 1		By Debenture Application and Allotment Account	2500	0	0

The amount of the premiums received by the company should not be transferred to the Profit and Loss Account but should be retained on the Premium Account, which may be debited with the expenses connected with the issue instead of those expenses being charged to Profit and Loss Account.

INCREASE AND DECREASE OF CAPITAL

Increase

When a company increases its nominal capital it is generally for the purpose of making a further issue of shares. The additional amount of nominal capital does not require any entry in the books of account, but if new shares are allotted entries must be made similar in all respects to those made on the original issue. Application, Allotment, and Call Accounts must be debited, and Share Capital Account credited, with the amounts payable as shown on pp. 165 and 166. This must be repeated on every issue.

Sometimes a company makes a distribution of shares in payment of a dividend. In such a case the Dividend Account must be debited, and the Share Capital Account credited, with the nominal value of the shares. If the shares are distributed at a price above par the Dividend Account must be debited with the full amount at which they are valued, Share Capital Account being credited with the nominal value, and Premium on Shares Account credited with the difference.

Decrease

The several ways in which the paid-up or the issued capital may be reduced have been fully explained in Part III, Chapter IV. The entries to be made in the books of account to record the facts in each case will depend upon the method by which the capital has been reduced, but there is one entry common to all, viz. a debit to Share Capital Account of the amount of the reduction. This is, of course, necessary in order to record the fact that the liability of the company to its shareholders on Capital Account has been reduced either permanently or temporarily. Besides the entries in the financial books, a record must be made on the accounts of the shareholders in the Share Ledger that the nominal amount of the shares has been reduced in each case.

To take first the case of a decrease of capital arising from a return to shareholders of surplus profits not distributed as dividends, this may be a temporary reduction only, as any amount returned to shareholders will be available to be called up in case of necessity. The entries necessary are a debit to Share Capital Account and a credit to cash of the amount returned. There should also be a transfer of the amount from the Profit and Loss Account to the Reserve Fund Account. Cases of this kind are comparatively rare.

Reductions of capital are usually made in the case of companies whose assets have shrunk considerably in value, or which have traded at a heavy loss and thus accumulated a large debit balance on the Profit and Loss Account. There is often a combination of both circumstances, and for purposes of illustration an instance will be taken where this is the case.

The following is the balance sheet of such a company:—

BALANCE SHEET OF THE DEMOS BREWERY COMPANY, LTD., AS AT 31 DECEMBER, 1912

Capital and Liabilities	£	s.	d.	*Assets*	£	s.	d.
AUTHORIZED CAPITAL:				Freehold Brewery, Plant, Machinery, &c.	100,000	0	0
1,000,000 6 per cent Preference Shares of £1 each £1,000,000				Freehold and Leasehold Licensed Properties	1,000,000	0	0
1,000,000 Ordinary Shares of £1 each 1,000,000				Goodwill	1,000,000	0	0
£2,000,000				Horses, Drays, Barrels, &c.	50,000	0	0
				Stocks	40,000	0	0
CAPITAL ISSUED AND PAID UP:				Debtors for Mortgages, &c.	175,000	0	0
750,000 6 per cent Preference Shares £750,000				Cash at Bank and in hand	10,000	0	0
1,000,000 Ordinary Shares 1,000,000				Profit and Loss Account—Balance of Loss	150,000	0	0
	1,750,000	0	0				
FIRST MORTGAGE DEBENTURES:							
5000 4½ per cent First Mortgage Debentures of £100 each	500,000	0	0				
Mortgages on Company's Properties	250,000	0	0				
Trade Creditors	25,000	0	0				
	2,525,000	0	0		2,525,000	0	0

A valuation of the properties was made which came out at £650,000. It was decided to write off the depreciation on the properties and to extinguish the debit on the Profit and Loss Account. A scheme was passed by the shareholders and approved by the Court under which the Ordinary shares were reduced to shares of 5*s.* each, and the Preference shares to 15*s.* each, the amount of the reduction being used to carry out the decisions above mentioned, and to write down the value of the goodwill as far as possible. The following would be the entries necessary to be made in the company's books of account to give effect to the alterations:—

JOURNAL

1913.				£	s.	d.	£	s.	d.
Mar.	31	PREFERENCE SHARE CAPITAL ACCOUNT	*Dr.*	187,500	0	0			
		ORDINARY SHARE CAPITAL ACCOUNT	"	750,000	0	0			
		To Freehold and Leasehold Properties					350,000	0	0
		" Goodwill					437,500	0	0
		" Profit and Loss Account					150,000	0	0
		Being the amount of the reduction of the capital of the Company, applied in accordance with the scheme sanctioned by the Court on 5 March, 1913.							

LEDGER

Dr. PREFERENCE SHARE CAPITAL ACCOUNT *Cr.*

1913.			£	s.	d.	1913.			£	s.	d.
Mar.	31	To Sundries per Journal	187,500	0	0	Jan.	1	By Balance	750,000	0	0
		" Balance c/d	562,500	0	0						
			750,000	0	0				750,000	0	0
						Apr.	1	By Balance b/d	562,500	0	0

ORDINARY SHARE CAPITAL ACCOUNT

1913.			£	s.	d.	1913.			£	s.	d.
Mar.	31	To Sundries per Journal	750,000	0	0	Jan.	1	By Balance	1,000,000	0	0
		" Balance c/d	250,000	0	0						
			1,000,000	0	0				1,000,000	0	0
						Apr.	1	By Balance b/d	250,000	0	0

FREEHOLD AND LEASEHOLD PROPERTIES

1913.			£	s.	d.	1913.			£	s.	d.
Jan.	1	To Balance	1,000,000	0	0	Mar.	31	By Sundries per Journal	350,000	0	0
								" Balance c/d	650,000	0	0
			1,000,000	0	0				1,000,000	0	0
Apr.	1	To Balance b/d	650,000	0	0						

GOODWILL

1913.			£	s.	d.	1913.			£	s.	d.
Jan.	1	To Balance	1,000,000	0	0	Mar.	31	By Sundries per Journal	437,500	0	0
								" Balance c/d	562,500	0	0
			1,000,000	0	0				1,000,000	0	0
Apr.	1	To Balance b/d	562,500	0	0						

PROFIT AND LOSS ACCOUNT

1913.			£	s.	d.	1913.			£	s.	d.
Jan.	1	To Balance	150,000	0	0	Mar.	31	By Sundries per Journal	150,000	0	0

After making these entries the Balance Sheet of the company would appear as under:—

BALANCE SHEET OF THE DEMOS BREWERY COMPANY, LTD., AND REDUCED AT 1 APRIL, 1913.

Capital and Liabilities		£	s.	d.	*Assets*	£	s.	d.
AUTHORIZED CAPITAL:					Freehold Brewery, Plant, Machinery, &c.	100,000	0	0
1,000,000 6 per cent Preference Shares of 15s. each	£750,000				Freehold and Leasehold Licensed Properties	650,000	0	0
1,000,000 Ordinary Shares of 5s. each	250,000				Goodwill	562,500	0	0
	£1,000,000				Horses, Drays, Barrels, &c.	50,000	0	0
CAPITAL ISSUED AND PAID UP:					Stocks	40,000	0	0
750,000 6 per cent Preference Shares		562,500	0	0	Debtors for Mortgages, &c.	175,000	0	0
1,000,000 Ordinary Shares		250,000	0	0	Cash at Bank and in hand	10,000	0	0
FIRST MORTGAGE DEBENTURES:								
5000 4½ per cent First Mortgage Debentures of £100 each		500,000	0	0				
Mortgages on Company's Properties		250,000	0	0				
Trade Creditors		25,000	0	0				
		1,587,500	0	0		1,587,500	0	0

The procedure is thus to ascertain the amount of loss the company has sustained both in respect of capital assets and on trading, and to treat this as a loss of the shareholders' capital. The paid-up value of the shares is then reduced to an extent sufficient to provide the sum it is decided to write off the assets, and to extinguish any debit balance on the Profit and Loss Account.

Reductions of capital by cancelling shares not issued or by reducing a liability not called up do not require any entries in the books of account, as in neither case has any entry been previously made relating to the capital which is extinguished.

If a reduction be made by paying off out of surplus cash in hand capital not required for purposes of the business, the only entries necessary are a debit to the Share Capital Account and a credit to cash of the amount so paid.

CHAPTER VI

DEPRECIATION, RESERVE FUNDS, AND SINKING FUNDS

Depreciation—Reserves and Reserve Funds—Sinking Funds

DEPRECIATION

Reference has already been made to the subject of depreciation in relation to the balancing of the books, but further discussion of the question is now necessary in regard to the provision to be made under this head, the method to be adopted in fixing the amount or rate of such provision, and the treatment in the books of the amount it is decided to provide.

Practically all property except freehold land depreciates in value merely by effluxion of time, without taking into consideration other factors, such as wear and tear arising from use and obsolescence caused by a new invention. These are the three principal factors affecting the question, and their relative importance in any particular case depends upon the nature of the property or asset to be dealt with.

Effluxion of Time

The question of time is of the utmost importance in the cases of leases and patent rights, and any other property or right held for a limited period, after which the asset ceases to exist or reverts to another. In such cases the cost of the asset will be absolutely lost to the lessee or patentee, as the case may be, subject to any residue of value there may be in the case of patents arising from the connection with the customers who have dealt with the patentee during the term of the patent. This, however, is in the nature of goodwill, and cannot strictly be regarded as any residue of value in the patent itself. (As to PATENTS, see Part III, Chapter XIV.) A lease or any other grant for a definite period ceases to have any value when the term expires.

When the asset is acquired the cost, whether premium, purchase price, or cost of experiments, is debited in the books to a Lease or Patent Account, and figures as an asset in the Balance Sheet at the cost price. Unless steps be taken to provide for the steady loss of value caused by the gradual expiry of the grant, the time will come when all value will have disappeared, while the property remains at its original cost as an asset in the books and Balance Sheet. The result of neglect to provide for depreciation under this head will therefore be to necessitate the writing off in a lump sum at the end of the period of the value of the asset, which might have the effect of extinguishing the profits of that particular year. Further, there is a failure to show the true position of a business from time to time, unless the assets are always shown at their real values.

Wear and Tear

This consideration arises particularly in relation to working plant and machinery, and is of first importance in the case of factories, mills, and engineering works. In these cases the loss arising from the use of machinery is an important item of cost in the manufacture of the article a business produces. Machinery in the majority of cases has a known period of usefulness. During its working life it is being consumed in the process of manufacture just as much as the materials upon which it works. There is thus a twofold effect to be recorded by charging the manufacturing account with a sum representing the used-up value of the machinery and writing off a like amount from the value of the asset. These considerations apply also to the assets such as leases mentioned above, but the direct applicability of the principle is not so obvious.

Obsolescence

The possible loss of value under this head is more difficult to provide for. The assets to which it particularly applies are machinery, machine tools, and mechanical appliances generally, which are either used for manufacture or are the articles in which the business trades. Plant laid down for the manufacture of a certain article may serve that

purpose efficiently for a fairly well known period whatever new inventions may be introduced, but such inventions may be of a nature to enable the article to be produced more rapidly and economically than with the existing plant. In such a case a manufacturer would be at an enormous disadvantage as compared with a trade rival who adopted new methods, and would either have to scrap his plant and lay down the new system or be driven out of the market. This applies also to some products of manufacture, notably motor engines, which, in recent years, have developed so rapidly, that models a year or two old and in good working order are out of date and unsaleable except at a great sacrifice. The question of loss of value by supersession may therefore have to be considered in relation to two important assets, viz. the manufacturing plant and the stock in trade. The provision to be made to meet this contingency is much more difficult to determine than loss arising merely from wear and tear. It can be nothing but conjecture at best, and in practice is generally ignored. In the case of new industries, however, it should never be overlooked, as the possibility of new inventions is much more likely there.

Principles to be Observed

The assets of a business should always appear in its books as nearly as possible at their true value. It may be assumed that the initial cost is a fair measure of their value at the time they are acquired, and the problem for the trader is, what provision should be made to keep them at their real worth to the business as a going concern, having regard to their increasing age from year to year. Most assets, except those held for a fixed term, have a residual value at the end of their period of efficiency. The amount to be written off as loss will therefore be the difference between the cost and that remaining value. But during the life of the asset expenditure will undoubtedly be required upon it to maintain it in a state of efficiency. Repairs and renewals are always necessary in the case of plant and machinery and many other assets. Provision must accordingly be made to charge against the profits of the undertaking the cost of repairs and renewals and the loss of value arising from the using up of the property. In other words, the amount to be written off will be the total expenditure upon the property, whether original cost or subsequent maintenance, less any realizable value remaining at the end of the period of efficiency. The earning power of machinery and similar assets is not as great in their later years, but, subject to this, it may be said that a business benefits to an equal extent each year from the use during its working life. It is therefore desirable to spread the loss as equally as possible over the whole period.

Methods of making Provision

There are three principal methods of giving effect to a decision to provide for the extinction of an asset. The first is to charge each year with an equal fraction of the original cost, plus the expenditure on maintenance. This will have the desired effect of reducing the book value to the realizable value by the time the asset becomes useless, provided the period of efficiency has been correctly estimated. But as maintenance cost will be lower in the early years than in the later, the effect will be a heavier charge on the business when the asset is at its lowest point of efficiency.

The second method is to charge the expenditure on maintenance, and in addition to write off a fixed percentage from the book value each year, the rate being fixed at a figure which, calculated upon the gradually diminishing value, will reduce the machinery to its realizable value by the time it ceases to be efficient. The percentage charge is thus heavier in the early years when the cost of repairs and renewals will be lowest. This method, therefore, has the advantage of tending to equalize the charge.

The third method is to write off annually the difference between book value and actual value as ascertained by valuation. This, like the first method, will probably, after the first year, have the effect of throwing the major portion of the charge on the later years when the depreciation will be more rapid.

Ordinarily the first method is applicable to leases and patents, and the second method to plant and machinery. It is, however, desirable to have periodical valuations of the plant and machinery for comparing the actual value with the book value shown by the method adopted. This affords a useful check upon the rate of depreciation, which may be raised or lowered as the valuation may show to be desirable.

In connection with leases another method is sometimes adopted. It consists in charging against the Profit and Loss Account each year a sum which will be sufficient at the expiration of the lease to write off the original cost plus interest on the diminishing book value from year to year. The reason for this is that the premium may be regarded as rent paid in advance in a lump sum in consideration of the annual rent being less than would otherwise be payable. But, as the business is losing the use of the amount paid as premium,

the interest is charged in order to arrive at the true rent for the use of the premises. The business benefits from their occupation to an equal extent each year, and the charge is therefore made by equal annual instalments. This is done by calculating the amount of interest chargeable on the balance standing to the debit of the lease account from time to time and dividing the total, plus the cost of the lease, by the number of years the lease has to run. This system is known as the annuity system.

Entries in the Books

If it be decided to write off the cost of an asset by equal annual instalments, all that is necessary is to debit the Profit and Loss Account year by year with an equal fraction of the cost and to credit the account of the asset. If the method adopted is to write off the difference between book value and actual value, as shown by expert valuation, the Profit and Loss Account must be debited and the asset credited with the amount of the difference. These methods hardly require illustration.

To illustrate the method of writing off an asset by a percentage on diminishing value, let the case be taken of machinery which has cost £5000 to instal. It is expected to last twenty years, and then to realize £600. To reduce the machinery to this amount by the time it becomes useless for working, it is decided to write off 10 per cent from the diminishing book value each year, and to charge repairs and renewals to Profit and Loss Account yearly as they are executed. The Machinery Account would appear in the books as under:—

MACHINERY ACCOUNT

1912.		£	s.	d.	1912.		£	s.	d.
Jan. 1	To Cash—Cost of Machinery.....	5000	0	0	Dec. 31	By Depreciation—10 per cent of Cost.....	500	0	0
						" Balance c/d.....	4500	0	0
		5000	0	0			5000	0	0
1913.					1913.				
Jan. 1	To Balance b/d.....	4500	0	0	Dec. 31	By Depreciation—10 per cent of book value.....	450	0	0
						" Balance c/d.....	4050	0	0
		4500	0	0			4500	0	0
1914.					1914.				
Jan. 1	To Balance b/d.....	4050	0	0	Dec. 31	By Depreciation—10 per cent of book value.....	405	0	0
						" Balance c/d.....	3645	0	0
		4050	0	0			4050	0	0
1915.					1915.				
Jan. 1	To Balance b/d.....	3645	0	0	Dec. 31	By Depreciation—10 per cent of book value.....	364	10	0
						" Balance c/d.....	3280	10	0
		3645	0	0			3645	0	0
1916.					1916.				
Jan. 1	To Balance b/d.....	3280	10	0	Dec. 31	By Depreciation—10 per cent of book value.....	328	1	0
						" Balance c/d.....	2952	9	0
		3280	10	0			3280	10	0
1917.					1917.				
Jan. 1	To Balance b/d.....	2952	9	0	Dec. 31 to 31 Dec., 1931.	By Depreciation at 10 per cent of book value written off annually as above.....	2344	11	2
					1931.				
					Dec. 31	" Balance c/d.....	607	17	10
		2952	9	0			2952	9	0
1932.					1932.				
Jan. 1	To Balance b/d.....	607	17	10	Jan. 1	By Cash from sale of old machinery.....	600	0	0
						" Profit and Loss Account to write off Balance.....	7	17	10
		607	17	10			607	17	10

It has been assumed that the old machinery will realize exactly £600 on January 1st, 1932. The balance not covered by the depreciation written off is transferred to the Profit and Loss Account. The cost of the new machinery will be debited to a new Machinery Account opened for the purpose.

Annuity System

The writing off of the cost of a lease, plus interest at 5 per cent on the yearly outstanding balance, would, in the case of a lease for ten years costing £2000, be effected as shown below:—

LEASE ACCOUNT

			£	s.	d.				£	s.	d.
1912.						1912.					
Jan.	1	To Cash—Cost of Lease	2000	0	0	Dec.	31	By Depreciation	259	0	0
Dec.	31	" Interest at 5 per cent	100	0	0			" Balance c/d	1841	0	0
			2100	0	0				2100	0	0
1913.						1913.					
Jan.	1	To Balance b/d	1841	0	0	Dec.	31	By Depreciation	259	0	0
Dec.	31	" Interest at 5 per cent	92	1	0			" Balance c/d	1674	1	0
			1933	1	0				1933	1	0
1914.						1914.					
Jan.	1	To Balance b/d	1674	1	0	Dec.	31	By Depreciation	259	0	0
Dec.	31	" Interest at 5 per cent	83	14	0			" Balance c/d	1498	15	0
			1757	15	0				1757	15	0
1915.						1915.					
Jan.	1	To Balance b/d	1498	15	0	Dec.	31	By Depreciation	259	0	0
Dec.	31	" Interest at 5 per cent	74	18	9			" Balance c/d	1314	13	9
			1573	13	9				1573	13	9
1916.						1916.					
Jan.	1	To Balance b/d	1314	13	9	Dec.	31	By Depreciation	259	0	0
Dec.	31	" Interest at 5 per cent	65	14	8			" Balance c/d	1121	8	5
			1380	8	5				1380	8	5
1917.						1917.					
Jan.	1	To Balance b/d	1121	8	5	Dec.	31	By Depreciation	259	0	0
Dec.	31	" Interest at 5 per cent	56	1	5			" Balance c/d	918	9	10
			1177	9	10				1177	9	10
1918.						1918.					
Jan.	1	To Balance b/d	918	9	10	Dec.	31	By Depreciation	259	0	0
Dec.	31	" Interest at 5 per cent	45	18	6			" Balance c/d	705	8	4
			964	8	4				964	8	4
1919.						1919.					
Jan.	1	To Balance b/d	705	8	4	Dec.	31	By Depreciation	259	0	0
Dec.	31	" Interest at 5 per cent	35	5	6			" Balance c/d	481	13	10
			740	13	10				740	13	10
1920.						1920.					
Jan.	1	To Balance b/d	481	13	10	Dec.	31	By Depreciation	259	0	0
Dec.	31	" Interest at 5 per cent	24	1	8			" Balance c/d	246	15	6
			505	15	6				505	15	6
1921.						1921.					
Jan.	1	To Balance b/d	246	15	6	Dec.	31	By Depreciation	259	2	3
Dec.	31	" Interest at 5 per cent	12	6	9						
			259	2	3				259	2	3

Necessity for Charging Depreciation

The making of a proper charge for depreciation is of vital importance, as it is as much a working expense as current charges paid in cash. The asset, whether machinery or a lease for which a premium has been paid, is being consumed in the process of manufacture, and unless an adequate

charge is made for this in the Profit and Loss Account the profits of the business will be overstated. Once a basis has been fixed there should be no departure from it unless under exceptional circumstances. There must not be a reduction because the profits of a particular year are lower than usual. It is not a question of what the business can afford to charge for depreciation but what is the proper amount, and any failure to make a sufficient charge in some years will have to be paid for later at a time when the business can least afford it, viz. when the asset is worn out.

Replacement of Assets

The writing down of an asset used in a business to its realizable value is not the only problem which confronts a trader. He has to provide also for the replacement of the worn-out machinery or for the renewal of his lease as the case may be. Mere book entries will not suffice for this. He must put his hand in his pocket to pay for a new lease or new plant. This may mean crippling the resources of the business or introducing new capital. To avoid either course it is advisable to provide for the replacement of the machinery or the renewal of the lease by a Sinking Fund of the required amount. The means adopted to effect this are explained later in this chapter. (See p. 190.) In connection with leases a practice which finds considerable favour is to take out a Leasehold Redemption Policy with an Insurance Company, which in consideration of an annual premium undertakes for the payment of an agreed sum at the date when the current lease expires.

Leases have been taken above as typical of one class of depreciating property and machinery of another. There are, of course, many other assets which depreciate in a like manner, and the following table may be found useful as a guide in fixing rates of depreciation on diminishing value for various kinds of property:—

	Per Cent.
Boilers	10 to 15
Engines	5 " 10
Boilers and Engines together	7½ " 15
Casks	7½ " 10
Factories, Freehold (according to use)	2 " 5
Freehold Buildings other than Factories	1½ " 2½
Fixtures and Furniture	7½ " 10
Horses	15 " 20
Locomotives	7½ " 10
Machinery and Plant	5 " 10
Ships	5
Wagons	7½ to 10

RESERVES AND RESERVE FUNDS

Arising partly out of the question of depreciation is the subject of reserves and reserve funds. In some undertakings the amount of the provision for depreciation, instead of being credited to the account of the asset affected, is credited to a Depreciation Reserve Account, which appears in the Balance Sheet on the liabilities side at the amount accumulated from time to time. The effect is, of course, the same, but the amount of the depreciation provided is shown in full as against the cost of the asset. This method is generally used in connection with those undertakings whose accounts are kept on the Double Account system. (See Chapter VII of this Part.)

But depreciation is not the only matter in respect of which reserves are created. Mention has been made in Chapter II of reserves for doubtful debts and discount, and there are other matters in respect of which reserves are sometimes made, e.g. unexpired risks in the case of an Insurance Company. When a reserve is made for a specific object it should be so described, and not shown in the Balance Sheet under the title of "Reserve Account" only. All the reserves mentioned above are in respect of what may be called actual expenses of the business, and are thus properly chargeable in the Profit and Loss Account before arriving at the net profit of the undertaking. Such reserves are provided for certain losses and expenses which it is known will be incurred, but the amount of which cannot be precisely ascertained at the moment. If the extent of the loss were known, it would be charged at the definite amount. Pending its ascertainment, a sum is held in suspense which will be available when the amount is actually known.

Reserves of Surplus Profits

Apart from reserves made for anticipated losses, many undertakings, particularly companies, set aside a portion of their net profits instead of distributing them. The sum so reserved appears in the Balance Sheet under various titles, such as "Reserve", "Reserve Account", "Reserve Fund", and "Rest". There is a clear distinction between such a reserve and those to which reference has hitherto been made. The reserves now being dealt with are not set aside to meet expected losses or expenses. They would certainly be available for any loss that might arise, but they are more for the purpose of strengthening the general financial position of the business. They consist of profits which might have been divided amongst the share-

holders by way of dividend but have been retained in the business. The existence of such a reserve shows that the undertaking has a surplus of assets over and above the proprietors' capital and the amount due to outside creditors.

Nature of a General Reserve

Considerable misapprehension exists as to the nature of this kind of reserve, particularly when it is described as a "Reserve Fund". The enquirer is inclined to ask: "Of what does the fund consist?" "Which of the assets is the Reserve Fund?" It is sometimes possible to point to the particular items on the assets side of the Balance Sheet which do, in fact, make up the reserve fund. This is when the fund is invested outside the business; but the general practice is not to take this course. The method usually adopted is to retain the undistributed profits which make up the reserve fund in the business and to use them in carrying it on. The fund in such cases is not earmarked, but is somewhere among the assets. The realized profits, instead of being turned into cash and retained in that condition or invested separately, are used to buy more stock-in-trade or other property, and so, while being undistinguishable, still exist in some form or other. Shareholders in limited companies would have less difficulty in understanding the position if they would regard the Reserve Fund merely as a surplus of assets.

Investment or Use of a General Reserve

Opinion amongst accountants is divided as to the desirability of investing the reserve fund outside the business in all cases, but there are some undertakings as to which there is no doubt. In banks and financial institutions it is obviously necessary to have the reserve fund available in readily realizable securities, and that is the practice in all such undertakings of importance. But in commercial concerns where expansion is possible by use of the reserve of undivided profits for the purpose, it is generally conceded that it is justifiable to use the reserve for that object. The retention of the reserve in the business usually appeals to the shareholders of a concern making large profits, for the alternative would be either to invest in securities paying a low rate of interest or to distribute the reserve in dividends and issue new capital to develop the business, with the result that there would be a larger amount of capital on which to pay dividends. It would no doubt enable shareholders better to understand the position if accountants would describe the item as a "Reserve Fund" when it is specially invested, and as "Reserve" or "Reserve Account" when it is being used in the business. A better plan still is that adopted by a prominent joint-stock company, which states it thus:—

RESERVE:		
Invested in British Government Stock	£1,000,000	
Invested in the Company's Business Assets	1,000,000	
		£2,000,000

Secret Reserves

In addition to the reserves which appear in the Balance Sheet, some undertakings are in such a prosperous condition that they are able to create what are known as secret or internal reserves. These are really additional reserve funds which are not known to the general body of proprietors or to the outside world. The means by which these secret reserves are created are the writing off of excessive or unnecessary depreciation or reserves, charging capital expenditure to revenue, understating profits or assets, or overstating liabilities. Some banks show their business premises in their Balance Sheets at much less than they are really worth. The Bank of England premises, which are manifestly of great value, do not appear in its Balance Sheet at all.

The effect of creating a secret reserve is to strengthen the financial position of an undertaking. Exceptional losses can be met without drawing upon the general reserve, and dividends may be maintained at a steady rate, notwithstanding fluctuating profits, by reason of the ability to draw upon the secret reserve. But the system has serious drawbacks. If the object be to show steady results, it involves not only understating the profits of a good year, but inflating those of a bad one. Further, the true position of the undertaking is not disclosed to the shareholders for the time being, who lose dividends and also, if they sell their shares, the higher price which they should command if the real financial strength were known.

SINKING FUNDS

A Sinking Fund consists of moneys set aside out of profits periodically and invested outside the business so as to earn interest which is not withdrawn, but is allowed to accumulate with the principal until they make up together a certain amount. A Sinking Fund is raised when it is

known that a definite sum will be required at a fixed future date for a specific purpose. It is accumulated gradually in order to obviate the inconvenience which would be caused by withdrawing a considerable amount from a business in one sum. It differs from a reserve fund in that it is raised for a definite object which is known to exist at the time of commencing to accumulate the fund, and it must exist separate and distinct from the general assets of the business. A reserve fund, on the other hand, is not, as a rule, raised for any specific purpose other than the strengthening of the position of the business, and may or may not be invested outside.

Objects of Sinking Funds

There are many purposes for which sinking funds are created, including the purchase of new plant and machinery, renewal of leases and other assets, repayment of loans on debentures or otherwise. Any of these objects might require a considerable sum, which would probably not be readily available from the general assets when required. The date when the money will be wanted is definitely known in all cases except replacement of machinery, and even then it can be closely approximated. It is, therefore, possible to calculate how much must be set aside periodically and invested at a given rate of interest in order to amount to the sum required by the time it is wanted. There is, of course, an element of uncertainty in the fluctuating price of even gilt-edged stocks which may cause a difference when the accumulated fund is realized, but except for this factor the amount of the instalments required to raise the fund can be ascertained exactly.

Whatever may be the purpose for which the fund is required, the steps to be taken and the entries to be made in the books are the same. Two things have to be done on the occasion of the investment of each instalment. (1) Charge the Profit and Loss Account with the amount which it has been decided to invest periodically. (2) Take the same amount out of the bank and invest it in the purchase of a first-class security. Further, as interest on the investment is received each year, it must also be invested in the same or a similar security, since the basis of the fund is that it will accumulate at compound interest.

If the object of the fund be to replace a wasting asset, such as plant and machinery, the charge against the Profit and Loss Account is really an expense of carrying on the business as explained above under the head of "Depreciation"; but if the object be to repay debentures or other loans, the charge is a setting aside of a portion of the net profits after making all charges in respect of expenses. This point is of importance in relation to the Profit and Loss Account, inasmuch as a charge against the working account for the repayment of loans would unfairly decrease the profits, and might prejudice the owner of a business in the event of a sale.

Method of Creation

The first step to be taken when inaugurating a sinking fund is to ascertain the amount of the periodical instalments which must be invested to produce with compound interest the amount required. This will depend upon the rate of interest to be obtained from the investment, which should not be placed higher than $3\frac{1}{2}$ per cent. Three per cent is a more advisable rate, as it allows some margin for income tax and possible depreciation of the investment. Having fixed the amount of the instalment, an entry must be made debiting the Profit and Loss Account with the amount. A corresponding entry must be made crediting another account with the same sum in order to preserve the principle of double entry. The name of that account depends upon the object for which the sinking fund is being created. If it is for the renewal of a lease, it may be called a "Leasehold Redemption Account"; if for replacement of machinery, a "Machinery Depreciation Fund"; if for the repayment of debentures, a "Debenture Redemption Account". At the same time a similar amount of cash must be invested outside the business. This will appear as a payment in the Cash Book, and will be posted to the debit of an account which may be entitled the "Sinking Fund Investment Account". As interest on the investment is received it will be entered in the usual way on the debit side of the Cash Book, and credited to the Redemption or Depreciation Fund Account as the case may be. It will then be invested in the purchase of further securities, the Investment Account being debited and cash credited with the amount. These processes are repeated each year as the instalments are set aside and income from the investment is received.

To illustrate the working of the principle, let the case be taken of a company which has laid down plant and machinery costing £2000 on 1 January, 1912, which will have to be replaced in ten years. It is decided to provide the amount out of profits and to raise a sinking fund for the purpose, the interest to be earned being taken at 3 per cent. It is found that the amount of the annual instalments should be £174, 10s., no allowance being made for any value of the machinery at the end of the period, it being decided to set

this against possible depreciation of the investments and the loss and expense attending the installation of the new plant. At the end of the first year (31 December, 1912) a sum of £174, 10*s.* is withdrawn from the business and invested in the purchase of a first-class security. The amount is entered on the credit side of the Cash Book and posted to the debit of a Sinking Fund Investment Account. At the same time the Profit and Loss Account is debited and a Plant and Machinery Depreciation Fund Account is credited with the same amount. During the second year interest will be received and credited to the Depreciation Fund Account. At the end of the second year a further instalment, plus the interest received on the security, is invested in the purchase of further stock, and the process repeated year after year. The Depreciation Fund Account and the Sinking Fund Investment Account are shown in detail below for the whole period. The receipt of the income and the payment of the annual instalments, plus interest, for the purchase of further investments, are recorded in the Cash Book, and scarcely call for special illustration.

SINKING FUND INVESTMENT ACCOUNT

						£	*s.*	*d.*
1912.								
Dec.	31	To Cash—Instalment				174	10	0
1913.								
Dec.	31	To Cash—Interest at 3 per cent	£5	3	9			
		" " Instalment	174	10	0			
						179	13	9
						354	3	9
1914.								
Dec.	31	To Cash—Interest....	£10	11	7			
		" " Instalment	174	10	0			
						185	1	7
						539	5	4
1915.								
Dec.	31	To Cash—Interest....	£16	2	8			
		" " Instalment	174	10	0			
						190	12	8
						729	18	0
1916.								
Dec.	31	To Cash—Interest....	£21	17	1			
		" " Instalment	174	10	0			
						196	7	1
						926	5	1
1917.								
Dec.	31	To Cash—Interest....	£27	15	0			
		" " Instalment	174	10	0			
						202	5	0
						1128	10	1
1918.								
Dec.	31	To Cash—Interest....	£33	16	4			
		" " Instalment	174	10	0			
						208	6	4
						1336	16	5
1919.								
Dec.	31	To Cash—Interest....	£40	1	4			
		" " Instalment	174	10	0			
						214	11	4
						1551	7	9
1920.								
Dec.	31	To Cash—Interest....	£46	10	1			
		" " Instalment	174	10	0			
						221	0	1
						1772	7	10
1921.								
Dec.	31	To Cash—Interest....	£53	3	5			
		" " Instalment	174	8	9			
						227	12	2
						2000	0	0

MACHINERY DEPRECIATION FUND ACCOUNT

		£	s.	d.
1912.				
Dec. 31	By Profit and Loss Account	174	10	0
1913.				
Dec. 31	By Interest	5	3	9
	" Profit and Loss	174	10	0
		354	3	9
1914.				
Dec. 31	By Interest	10	11	7
	" Profit and Loss	174	10	0
		539	5	4
1915.				
Dec. 31	By Interest	16	2	8
	" Profit and Loss	174	10	0
		729	18	0
1916.				
Dec. 31	By Interest	21	17	1
	" Profit and Loss	174	10	0
		926	5	1
1917.				
Dec. 31	By Interest	27	15	0
	" Profit and Loss	174	10	0
		1128	10	1
1918.				
Dec. 31	By Interest	33	16	4
	" Profit and Loss	174	10	0
		1336	16	5
1919.				
Dec. 31	By Interest	40	1	4
	" Profit and Loss	174	10	0
		1551	7	9
1920.				
Dec. 31	By Interest	46	10	1
	" Profit and Loss	174	10	0
		1772	7	10
1921.				
Dec. 31	By Interest	53	3	5
	" Profit and Loss	174	8	9
		2000	0	0

Assuming that the life of the plant and machinery has been correctly estimated, the investments forming the sinking fund will be sold at the end of the twentieth year, and the sum realized used to purchase and lay down the new plant. The cash received from this source will be posted to the credit of the Sinking Fund Investment Account. It will rarely be the exact amount of the fund. Any difference must be transferred to the debit or credit of the Depreciation Fund Account, which will thus be swelled by an appreciation of the investments or decreased by their shrinkage in value. The book value of the old machinery is then written off by the transfer to the Depreciation Account of any difference after selling the old machinery, the balance of the Depreciation Account being transferred to a Reserve Account.

Suppose that in the case illustrated above the sinking fund investments realized £1950 only and the old machinery £150. The entries to be made in consequence would be as follows:—

SINKING FUND INVESTMENT ACCOUNT

		£	s.	d.			£	s.	d.
1921.					1922.				
Dec. 31	To Amount accumulated as shown above at cost	2000	0	0	Jan. 1	By Cash — Amount realized from Sale of Investments	1950	0	0
						" Transfer to Machinery Depreciation Account	50	0	0
		2000	0	0			2000	0	0

MACHINERY DEPRECIATION FUND ACCOUNT

1922.			£	s.	d.	1921.			£	s.	d.
Jan.	1	To Transfer of Loss on Sale of Investments	50	0	0	Dec.	31	By Amount of Depreciation accumulated as shown above	2000	0	0
		" Transfer from Old Machinery Account	1850	0	0						
		" Transfer to Reserve Account	100	0	0						
			2000	0	0				2000	0	0

(OLD) MACHINERY ACCOUNT

1912.			£	s.	d.	1922.			£	s.	d.
Jan.	1	To Cash—Cost of Machinery	2000	0	0	Jan.	1	By Cash received from Sale of Old Machinery	150	0	0
								" Transfer of difference to Depreciation Fund Account	1850	0	0
			2000	0	0				2000	0	0

If the object of a Sinking Fund be to pay off debentures, the annual instalments, instead of being credited to a Machinery Depreciation Account, would have been credited to a Debenture Redemption Account. At the end of the period the debentures would be paid off out of the amount received from the sale of the investments, and the amount standing to the credit of the Debenture Redemption Account would be transferred to a Reserve Account representing the undistributed profits which had been utilized to pay off the debentures.

CHAPTER VII

THE DOUBLE ACCOUNT SYSTEM

This system is a method of presenting the final accounts of companies carrying on undertakings of a more or less permanent character. It was first prescribed by Parliament in the Regulation of Railways Act, 1868, for use by Railway Companies, and has since been laid down as the form in which gas and electric lighting companies which obtain parliamentary powers shall present their accounts. The system is in general use by companies which have raised capital for the purpose of acquiring or constructing undertakings which, when completed, will be used or worked to earn revenue for the proprietors. These companies do not buy and sell in the same sense as ordinary commercial concerns, but, like those named above, are usually engaged in carrying on what may be described as public services.

Division of Final Accounts

The distinguishing feature of the system is the division of the assets and liabilities into two classes —fixed and floating—which are exhibited in the final accounts in two separate statements. The first shows the receipts and expenditure on Capital Account, and gives details on the credit side of the various kinds of capital which have been raised by the Company for the purpose of constructing the undertaking. The debit side shows how such capital has been expended in the construction under several heads. The balance is generally an excess of capital raised over the total expenditure, but in some cases the expenditure exceeds the issued capital. This is usually due to expenditure on capital assets having been made out of revenue or out of borrowed money other than capital. The balance of this Capital Account is carried into a General Balance Sheet, which consists of the floating assets, such as the bank balance, investments, book debts, stock of stores, &c.; while on the other side are the floating liabilities, including the amounts due to creditors, the balance of the Revenue Account, any excess of capital raised over capital expenditure, and any Depreciation Fund which may have been created.

Reason for the System

The system takes its name from the fact that, in order to get a true view of the position of an undertaking which presents its accounts on this basis, it is necessary to take into consideration both the Capital statement and the general Balance Sheet. In an ordinary commercial concern all the assets and liabilities are shown in a single statement, viz. the Balance Sheet, and this is the reason why the usual commercial method is sometimes called the Single Account System. It must be clearly understood that there is no connection of any kind between the Single Account system and single-entry bookkeeping. The only method of bookkeeping worthy of the name is, as already mentioned, double-entry, and whatever basis may be adopted in the preparation of the final accounts, the records which lead up to them are all kept on double-entry principles.

The reason for the Double Account system having been laid down by Parliament for railway companies and similar undertakings was, no doubt, that as the authority of Parliament had been obtained to raise an amount of capital for a specific purpose, it was desirable, in the interests of the proprietors and the public, that the accounts should be presented in such a manner as to enable anybody easily to ascertain whether the capital raised had been expended on the object for which it was authorized. This object is certainly attained in the form prescribed, as will be seen from a perusal of the following summarized accounts of the Midland Railway Company as at 31 December, 1911:—

Dr. RECEIPTS AND EXPENDITURE ON CAPITAL ACCOUNT *Cr.*

	Amount Expended to June 30, 1911.	Amount Expended during Half-year to Dec. 31, 1911.	Total.		Amount Received to June 30, 1911.	Amount Received during Half-year to Dec. 31, 1911.	Total.
	£	£	£		£	£	£
To Expenditure:				By Receipts:			
On Lines open for Traffic	90,308,371	85,347	90,393,718	On Stocks and Shares, viz.:			
On Lines not commenced and in abeyance	254,904	8,998	263,902	2½ per cent Consolidated Perpetual Guaranteed Preferential Stock	—	—	10,501,394
On Steamboats	426,200	496	426,696	2½ per cent Consolidated Perpetual Preference Stock	86,316,065	33,132	34,550,644
On Working Stock	17,430,231	9,486	17,439,717	Preferred Converted Ordinary Stock	—	—	41,297,159
On Purchase of Ashley Canal	109,850	—	109,850	Deferred Converted Ordinary Stock			
On Subscriptions to other Railways, and Contributions to Joint Lines (in detail)	12,847,444	7,039	12,854,483	On Debenture Stock	28,663,529	54,262	28,717,791
				On Premium on Stocks and Shares	4,721,716	—	4,721,716
					119,701,310	87,394	119,788,704
				By Balance			1,699,662
	121,377,000	111,366	121,488,366				121,488,366

Dr. GENERAL BALANCE SHEET *Cr.*

	£	s.	d.		£	s.	d.
To Net Revenue Account—Balance at Credit thereof as per Account.....	2,400,247	0	0	By Capital Account—Balance at Debit thereof as per Account.....	1,699,662	0	0
„ Unpaid Dividends and Interest.....	23,500	0	0	„ Cash at Bankers.....	1,140,900	0	0
„ Dividend and Interest payable.....	487,587	0	0	„ Cash on Deposit at Interest.....	1,300,000	0	0
„ Amount received for Debenture Stock not yet sealed.....	33,381	0	0	„ Cash Invested in Shares of other Railway Companies, not charged as Capital Expenditure.....	11,009	0	0
„ Debts due to other Companies.....	344,844	0	0	„ General Stores—Stock of Materials on hand.....	1,603,927	0	0
„ Sundry Outstanding Accounts, including Tradesmen's Accounts.....	2,981,398	0	0	„ Traffic Accounts due to the Company.....	1,194,823	0	0
„ Steamboat Depreciation and Insurance Funds.....	199,669	0	0	„ Amount due by other Companies....	210,391	0	0
„ Fire Insurance Fund on Stations, Works, and Buildings.....	474,673	0	0	„ Amount due by the Clearing House	64,938	0	0
„ Superannuation Fund and Friendly Society.....	1,593,515	0	0	„ Amount due by Post Office for Carriage of Mails.....	20,807	0	0
				„ Sundry Outstanding Accounts.....	1,292,357	0	0
	8,538,814	0	0		8,538,814	0	0

These accounts, it will be observed, show quite clearly the difference in character between the assets and liabilities set out in the respective statements. The Capital Account shows in total the amount of capital raised by the Company and the manner in which it has been used in building the line, purchasing rolling stock, and acquiring other fixed and permanent assets. The General Balance Sheet, on the other hand, shows items which are largely of a temporary and fluctuating character, the respective amounts varying from day to day as debts are turned into cash and cash into stores or other assets.

Details of Capital Account

Detailed statements are attached to the Capital Account, showing the various heads on which the expenditure of the past half-year has been incurred. The expenditure on lines open for traffic, for example, is shown under three headings—"Land and Compensation", "Construction of Ways and Stations, including Rails, &c.", and "Law and Parliamentary Charges". The names of the several sections of the line on which money has been spent during the half-year are shown and the nature of the work indicated, such as additional siding accommodation, extension of the Company's hotel at Liverpool, new roads, signal improvements, Additional Powers Act, &c.

In companies in which the double account system is adopted, the result of the working is shown in an account generally called the Revenue Account, which gives the same kind of information as the Profit and Loss Account of a commercial firm, allowing for the difference in character between the two concerns. There is shown on p. 198 the Revenue Account of the Midland Railway Company for the six months ending 31 December, 1911.

This Revenue Account is typical of the Double Account system, and it discloses what is generally regarded as a defect of principle. There is no obligation upon companies using this method of framing their accounts to provide for the depreciation of the fixed assets. The Capital Statement always shows those assets of the undertaking at their original cost, irrespective of their age or of the changes which take place in them. It is true that in this particular Revenue Account a charge is made for the depreciation on steamboats, but it will be seen on reference to the capital account that these represent a comparatively small proportion of the fixed assets.

Capital Expenditure charged against Revenue

It will be observed, however, that heavy charges are made for maintenance and repairs. It is by means of these charges that the defect of principle is remedied to some extent, for they include not merely the expense of keeping the assets in a working condition, but also the cost of replacing them by entirely new works, rolling stock, &c., which are thus borne as a charge against revenue. The effect of this treatment is, of course, that the old and worn-out assets are really represented in the accounts by new assets which have been bought out of revenue, while the cost of the original assets has really been written off. This has the further effect over a period of years of giving a trading result approximately correct; but it cannot be overlooked that the system, by omitting to charge de-

Dr. REVENUE ACCOUNT *Cr.*

Expenditure	£	s.	d.	Receipts	£	s.	d.
To Maintenance of Way, Works, and Stations	606,916	0	0	By Passenger Traffic	1,767,059	0	0
" Locomotive Power	1,174,093	0	0	" Parcels, Horses, Carriages, &c.	428,907	0	0
" Carriage and Wagon Repairs	389,020	0	0	" Mails	40,883	0	0
" Traffic Expenses	1,423,524	0	0	" Merchandise Traffic	2,500,514	0	0
" General Charges	136,443	0	0	" Live Stock Traffic	55,102	0	0
" Law Charges	7,234	0	0	" Mineral Traffic	1,865,425	0	0
" Parliamentary Expenses	6,382	0	0	" Canals Traffic	673	0	0
" Compensation—Personal Injury to Passengers	833	0	0	" Burton and Ashley Light Railways	7,184	0	0
" Compensation—Personal Injury to Workmen	10,476	0	0	" Carriage and Wagon Hire	5,730	0	0
" Compensation—Damage and Loss of Goods	29,360	0	0		6,671,477	0	0
" Rates and Taxes	218,645	0	0	" Rents from Tenants of Houses, Lands, &c.	108,323	0	0
" Government Duty	8,151	0	0	" Transfer Fees	1,765	0	0
" Steamboat Expenses £45,516							
" Depreciation and Insurance of Steamboats 14,514							
	60,030	0	0				
" Burton and Ashley Light Railways	6,333	0	0				
	4,077,440	0	0				
" Balance carried to Net Revenue Account	2,704,125	0	0				
	6,781,565	0	0		6,781,565	0	0

preciation, has the effect during the early years of an undertaking, when replacements are not required, of increasing the profits at the expense of later years which have to bear the cost of necessary renewals. This result is largely corrected by the creation of reserves which do not appear in the published accounts of the undertakings; but the better course would undoubtedly be to make a proper provision for the wasting of the assets by the ordinary commercial method of making an annual charge in this respect.

The argument advanced in justification of the omission to provide specifically for depreciation is, that as the undertakings using the double account system are of a permanent character, there is no necessity to charge depreciation so long as the assets are maintained in a high state of efficiency and replaced when necessary out of revenue. This, however, fails to rectify the inequality of the charge for replacements and renewals in the later years.

Abandoned Assets

There is a further matter in regard to which the system may be said to be lacking, viz. the failure to provide for the writing off of expenditure upon portions of the original undertaking which the company has ceased to work. Moneys expended on these objects are capitalized in the usual way when the works are constructed, but if for any reason it be decided to abandon them there is no obligation on the company to write them off either at once or over a period of years. Unless, therefore, some provision be made by the creation of a Depreciation Fund or otherwise, this expenditure will remain in the Capital Statement as an asset of value, although for practical purposes it is worthless. The expenditure on capital account also includes in the case of Parliamentary Companies the cost of passing the various special Acts under which the companies work. Without this expenditure the companies could not of course have commenced or carried on their undertakings, but there is no tangible asset to set against the expenditure incurred, although it may be regarded as in the nature of goodwill.

Special forms on the double account system have been prescribed under the authority of Parliament for Gas and Electric Lighting companies, in addition to Railway companies, and this method of presenting the accounts is in general use by companies and local authorities owning waterworks, tramways, canals, and docks, all of which may be said to be of a semi-permanent and public character. It is sometimes used by coal-mining companies also. In the case of Electric Lighting companies there is a slight variation from the general practice, by bringing into the General Balance Sheet the total capital raised on one side in a lump sum and the total capital expenditure on the other.

CHAPTER VIII

INCOME TAX

Introductory—Schedule D, "The Statutory Income"—Preparation of Income Tax Account—Appeals—The Essentials in Returns and Appeals.

INTRODUCTORY

Income Tax is a charge levied annually by the State upon the income of individuals resident in the United Kingdom from whatever source derived, and on the income arising from any profession, trade, employment, or vocation carried on here by any person, whether resident or not. It is charged on the income received or to be received in the year from 6 April to 5 April inclusive. Income tax in its general scope and its legal bearings has been considered in Part I, Chapter VIII.

The burden of the tax falls upon the person in receipt of the income, but the collection is made, wherever possible, at the source of the income rather than at its destination. Thus, when interest is paid on Consols tax is deducted by the Bank of England and paid by the Bank to the Government in one sum, the holder of the Consols receiving the net amount only. This procedure effects a considerable saving of time and expense to the Revenue authorities, who are able to collect the tax in large sums from banks in respect of interest and dividends on British and Colonial Government stocks which would otherwise have to be obtained from the very large number of persons who receive such interest.

The amount or rate of the tax is fixed annually by Parliament in the form of a poundage payable upon the amount of income. The rate may thus vary from year to year, and since 1907 two rates have been in force for different classes of income, viz. unearned and earned. Supposing the normal rate to be 1*s.* 2*d.* in the £, if the income chargeable is earned by the taxpayer and does not exceed £2000 per annum, the rate payable is only 9*d.* in the £. If the earned income exceeds £2000 but does not exceed £3000, the rate is 1*s.* in the £. All unearned income is chargeable at 1*s.* 2*d.* in the £. When the income from whatever source exceeds £5000 per annum, a super-tax of 6*d.* in the £ is payable on that portion in excess of £3000. A person whose income is earned, in order to be entitled to the relief of the lower rate of 9*d.* in the £, must make a claim before 30 September in each year to be charged at that rate. (See further, Part I, Chapter VIII.)

Limited Companies

The tax is one upon individuals, and abatements and exemption can be claimed by individuals only. Limited companies must pay in full on their total profits at the higher rate, and the tax so paid is usually deducted from the amount distributed amongst the shareholders by way of dividend. If any shareholder is entitled under the regulations to an abatement or exemption he must make application for a refund by the Revenue of the tax deducted from his dividend.

Many private companies are really partnerships in which only two or three persons are interested, all of whom work in the business, and who may therefore be said to earn the income. Other companies are really "one-man companies" in which the proprietor works and receives all the profits. In these cases tax is payable at the higher rate, and although claims for exemption or abatement may be made by the persons receiving the dividends from the company, the tax payable on the

balance of the income will be at that rate. In order to avoid this necessity it is not uncommon for such companies to pay high management salaries to the proprietors, who pay tax upon them at the "earned" rate.

Classification of the Tax

For convenience of collection the income arising from various kinds of property is classified under five schedules lettered "A" to "E". The rates at which tax is payable on earned and unearned income is the same under each schedule. The only class of income requiring detailed explanation from the point of view of accounts is that under Schedule D relating to the profits from trade, manufacture, profession, or vocation. The other schedules may be dismissed with a reference to Part I, Chapter VIII.

The amount of income upon which the tax under Schedule A is charged is based upon the annual value or poor-rate assessment, subject to a deduction of one-sixth of the value in the case of buildings, and one-eighth in the case of land, to cover the cost of repairs. Further deductions in respect of repairs will be allowed when it is shown that the amount expended on the property exceeds one-sixth or one-eighth as the case may be.

Schedule B relates to the income arising from the occupation of farms, market gardens, &c., and is borne by the occupier. The lower rates of tax on earned income are payable when the income does not exceed £3000 per annum. The amount on which the tax is charged is usually fixed at one-third of the amount of the annual rent, but the farmer or other person liable has the right to be charged on the average of his annual profits for the three preceding years if he so desires.

Schedule C includes the income arising from the interest, dividends, &c., payable on the Public Funds of the United Kingdom, the Colonies, Foreign Governments, and certain other stocks.

Schedule E relates to the remuneration or pensions payable to persons in the employment of others, charged in the majority of cases upon the estimated receipts of the year for which the charge is made, but clerks may elect to be charged on the average of three years. The income chargeable under this Schedule being earned income, the tax is payable at the lower rates when the amount received does not exceed £3000 per annum. Two returns are obtained by the Revenue under this Schedule. The first is from employers, who are required to furnish a list of all persons in their employ not entitled to exemption, giving their names, private addresses, and remuneration. A further return is then obtained from the employees by the local district assessors. This return requires the taxpayer to give particulars of all income from whatever source arising, in order that it may be seen whether he is entitled to exemption or abatement by reason of his total income falling below £160 or £700, and also whether he may claim to be charged at the lower rate owing to his earned income being under £3000. This return has to be sent to the local officer, and upon the information thus given the amount on which tax has to be paid is fixed or assessed.

SCHEDULE D, "THE STATUTORY INCOME"

The income chargeable under Schedule D is the profit arising from the carrying on of a trade or manufacture, or from a profession or vocation. The amount upon which the tax is payable is not necessarily or even probably the profit shown by the Profit and Loss Account of the business or profession, owing to the Income Tax authorities not allowing as revenue charges certain items which any prudent business man would charge in connection with his business before arriving at his net profit. The income is thus not the real income from the business, but a "Statutory Income" arrived at upon a basis fixed by the regulations and practice of Income Tax officials and by many decisions of the Courts. This Schedule depends upon returns made by the taxpayers.

In the ordinary course the return is brought before the Commissioners of Taxes, who thereupon make the assessment. As the District Commissioners sometimes include persons who may be trade rivals, the taxpayer has the right, when making the return, to claim to be assessed by the District Commissioners under a letter or number for the purpose of keeping his identity from their knowledge; or he may claim to be assessed by the Special Commissioners.

The tax is payable on 1 January in the year of assessment. It is not possible, therefore, to make a return of the actual income for the year. Nor do the authorities ask for or require an estimate of the actual profits except in the case of a business commenced within the year of assessment. The return is based on past results, and the amount to be inserted in the return as the income liable for assessment is the average of profits for three complete years of the business immediately preceding the year of assessment. Thus, if a trader makes up his accounts to 30 June in each

year, he will, when called upon for a return for the year ending 5 April, 1914, take as a basis the profits of his business for the years ending 30 June, 1910, 1911, and 1912. If the business has not been in existence as long as three years, the average profits from the time of commencement form the basis of the return.

The principle of basing the assessment on past results works hardship in cases where an exceptionally bad year of trading is experienced. The fact that the bad year will subsequently be brought into the averages for later years will in time effect an adjustment, but what the trader feels is the obligation to pay tax on very much larger profits than he has actually earned during the year in which he can least afford to pay. There was formerly a right to strike a new average after the close of the year by eliminating the first year originally included and substituting the result of the year just closed. This sometimes resulted in an appreciable amount being refunded by the Revenue for tax overpaid, but the right was abolished by the Finance Act, 1907, except in the case of new businesses established within three years. In such cases tax is paid on actual results, a refund being made by the Revenue if the assessed income is shown to have exceeded the profits.

The amount of profits upon which the return is based may differ considerably from the trading results as shown by the trader's accounts. This is because the views of the Income Tax authorities with regard to items properly chargeable against gross profit in order to arrive at the net result do not agree in several respects with the commercial practice. It is necessary, therefore, to prepare a special account for Income Tax purposes, which, although based on the accounts of the business as appearing in the books, will show a different result after making the various adjustments.

PREPARATION OF INCOME TAX ACCOUNT

As the amount of income to be returned is based upon the average of three years, the best course is to prepare a statement with three columns on each side, one for each year, comprising the figures of the Profit and Loss Accounts for the period included in the average. A note should then be made of the items included in the accounts which are not allowed by the authorities as charges or deductions from gross profit, and these amounts should be added to the net profit shown by the books. In order to do this, it is of course necessary to know what are the charges allowed and those not allowed. Further, there are certain items not usually regarded as expenses which are nevertheless allowed as deductions for Income Tax purposes, and which must be brought into account in arriving at the amount of the return.

Speaking generally, all expenses and disbursements incurred wholly and exclusively for the purpose of the business are allowed, and the following list may be taken as a guide to the charges or deductions permitted:—

1. Rent and rates of trade premises which are used exclusively for the business. In cases where the trader is the owner there will be no charge for rent in the Profit and Loss Account of the business. He may nevertheless charge in the Income Tax Account the net value of the premises as assessed for Schedule A;
2. Repairs of trade premises;
3. A proportion of the rent of premises used partly as business premises and partly as a residence, the amount allowed not to exceed two-thirds of the rent. Where the premises belong to the trader he may charge two-thirds of the Schedule A assessment;
4. Cost of implements and utensils used in the business not exceeding the average expenditure of the three preceding years;
5. Debts written off as bad, and also the estimated loss from doubtful debts in the discretion of the Commissioners;
6. Embezzlement and defalcation arising directly from carrying on the business; e.g. defalcation of a rent collector employed by an estate agent;
7. Fire and workmen's compensation insurance premiums;
8. Loss of stock by fire so far as the loss exceeds any amount recovered under insurance;
9. Bank interest and charges on current (not loan) account;
10. All other charges and expenses exclusively laid out on the production of profits, including salaries, wages, commission, motive power, discounts, &c.

In effect another deduction is allowed in respect of premiums for the insurance on the lives of the taxpayer and his wife. These must not, however, be charged as a deduction, but an allowance must be claimed in respect of them after the amount of statutory income or profit from the business has been arrived at.

In connection with the deductions allowed may be mentioned various items of income or profit which are not required to be brought into account for Income Tax purposes. These include—

1. Interest and dividends received on investments of the business, as tax will have been deducted before the income was received;
2. Profits on casual transactions not connected with the business, such as a Stock Exchange speculation—but habitual speculators must account;

3. Income received from a relative as a voluntary gift;

4. In the case of a Company, premiums received on the issue of shares, as this is a Capital profit.

The following are the principal deductions not allowed in arriving at the statutory income:—

1. Losses and expenses not necessarily incurred in trading; e.g. damages for injury caused by the trader's employees;

2. Cost of improvements and additions to premises, this being a capital expense;

3. Interest on capital;

4. Partners' salaries and drawings;

5. Annuities, royalties, ground rents, annual interest on loans or any other annual payment. The trader must deduct tax from such payments before making them, and thus recoup himself for not being allowed the charges in his Income Tax Account;

6. Depreciation of leases, goodwill, land, buildings, fixtures, patents, plant and machinery. Although no deduction may be made for depreciation of plant and machinery, an allowance for wear and tear may be claimed as mentioned below;

7. Expenses of maintenance of the trader and his family. Traders who supply their own requirements from the business must bring them into account by treating them as sales;

8. Income Tax under any Schedule;

9. Voluntary subscriptions or gifts;

10. Capital withdrawn from or invested in the business;

11. Losses recoverable under policies of insurance;

12. Reserves and sinking funds created for any purpose, these being regarded as capital charges;

13. Charges in respect of the exhaustion of a wasting property, such as a mine. This is treated as a capital loss;

14. Loss on a single or casual transaction not connected with the business.

The Income Tax Account on which the return is based must be prepared in accordance with the principles to be deduced from the allowance or disallowance of the above items. The following statements show how the rules are applied in adjusting the Profit and Loss Accounts of a business in accordance with the requirements of the authorities:—

TRADING AND PROFIT AND LOSS ACCOUNT
OF SMITH & JONES FOR THE THREE YEARS ENDING 30 JUNE, 1912

	1910.	1911.	1912.		1910.	1911.	1912.
	£	£	£		£	£	£
To Stock	1,280	1,320	1,350	By Sales, *less* Returns	45,836	47,495	48,631
" Purchases, *less* Returns	28,812	29,413	30,216	" Stock	1,320	1,350	1,340
" Wages	6,904	7,583	8,207				
" Gross Profit	10,160	10,529	10,198				
	47,156	48,845	49,971		47,156	48,845	49,971
To Salaries and Travellers' Commission	1,250	1,300	1,320	By Gross Profit	10,160	10,529	10,198
" Ground Rent	50	50	50	" Rent of Workmen's Cottages	720	723	722
" Rates, Water and Gas	250	260	260				
" Repairs to Premises	150	125	175				
" Income Tax, Schedule A, on Firm's own Premises	21	21	21				
" Income Tax, Schedule D	350	370	390				
" Travelling Expenses	230	210	200				
" Insurance	180	170	175				
" Advertising	385	350	370				
" Discounts and Allowances	721	740	680				
" Interest on Mortgage	100	100	100				
" Leasehold Redemption	60	60	60				
" Bad Debts	436	325	395				
" Reserve for Doubtful Debts	300	350	300				
" General Trade Expenses	275	290	217				
" Depreciation—							
Buildings	100	100	100				
Fixtures and Fittings	37	39	36				
Plant and Machinery	200	190	185				
" Interest on Capital	500	500	500				
" Partners' Salaries	2,000	2,000	2,000				
" Net Profit	3,285	3,702	3,386				
	10,880	11,252	10,920		10,880	11,252	10,920

ADJUSTED PROFIT AND LOSS ACCOUNT
FOR INCOME TAX PURPOSES

	1910.	1911.	1912.		1910.	1911.	1912.
	£	£	£		£	£	£
To Item not included above but allowed as a deduction by the regulations, viz.:				By Net Profit, per Profit and Loss Accounts above	3285	3702	3386
Assessment of Premises under Schedule A	360	360	360	" Additions in respect of Items charged above but not allowed as deductions by Income Tax authorities, viz.:			
" Item brought to credit above but not assessable under Schedule D, viz.:				Ground Rent (*a*)	50	50	50
Rents from Workmen's Cottages	720	723	722	Income Tax, Schedule A (*b*)	21	21	21
" Profit for Income Tax Purposes	5623	6049	5746	Income Tax, Schedule D (*b*)	350	370	390
				Interest on Mortgage (*a*)	100	100	100
				Leasehold Redemption (*d*)	60	60	60
				Depreciation—			
				Buildings (*c*)	100	100	100
				Fixtures and Fittings (*d*)	37	39	36
				Plant and Machinery (*e*)	200	190	185
				Interest on Capital (*f*)	500	500	500
				Partners' Salaries (*f*)	2000	2000	2000
	6703	7132	6828		6703	7132	6828

(*a*) These items are not allowed, as tax should have been deducted by the firm before paying the ground rent and interest. The Revenue authorities obtain the tax from the payer, following the principle of collecting the income at its source.

(*b*) Income Tax is not regarded as an expense incurred in earning profits, but as an apportionment of part of the net profits in favour of the Crown.

(*c*) No allowance is granted under this head, as the deduction of one-sixth of the annual value made for repairs when fixing the assessment under Schedule A is held to include depreciation.

(*d*) This is regarded as a capital charge or loss.

(*e*) While no deduction is allowed for depreciation of plant and machinery, an allowance may be claimed for wear and tear, as to which see below.

(*f*) These are treated as appropriations of profits to the partners, and not as expenses in carrying on the business.

Having arrived at the amount of the statutory income for each year, the average is ascertained, that being the amount which has to be returned as the amount assessable. Thus:—

Net Profit as adjusted for 1910	...	£5,623
" " " 1911	...	6,049
" " " 1912	...	5,746
		3) 17,418
		£5,806

The return in which this amount has to be entered is a four-page document which, when issued, is accompanied by a memorandum in which are set out a number of notes, explanations, and instructions for filling up the return. The first page of the document contains merely the formal request for the return of income and a form of declaration to be used in cases where a return has already been made, that this has been done.

Page two of the return is provided for stating the amount of untaxed income received by the taxpayer under various heads, viz.:—

1. From Trade, Profession, Employment, or vocation;
2. From Bank Interest or other interest of money not taxed by deduction, and from discounts;
3. From Colonial and Foreign Securities where the Tax is not deducted on payment;
4. From Foreign and Colonial Possessions;
5. From property or profits not falling under any of the above heads, the particular source to be stated.

The amount of £5806, the average profits as shown above, would be inserted against the first heading mentioned, and any income received from either of the other sources would also be entered on the return. It is to be observed that only income from which tax has not been deducted before its receipt by the taxpayer is to be included, such as interest and dividends on stocks and shares in foreign and colonial industrial undertakings and on the profits of businesses carried on abroad. Interest on Foreign and Colonial Government Stocks paid in this country would seldom be included, as the tax is, as previously mentioned, deducted by the bank or agent paying the interest. If there is no income from any of the sources in-

cluded under heads (2) to (5), the word "nil" must be entered in the money column against each heading. It is not sufficient to leave the column blank.

Deduction for Wear and Tear

The income under the several heads is totalled, and under the gross amount a space is provided for deduction of the amount claimed for wear and tear of machinery and plant. It must be emphasized that wear and tear is not the same thing as depreciation. The latter term includes wear and tear, but it embraces other things as well, such as a decrease of value arising from obsolescence caused by a new invention. No allowance can be obtained in such a case from the Revenue authorities, who regard it as a loss of capital and not an expense of carrying on the business. The allowance for wear and tear is intended to cover the necessary outlay on replacing worn-out plant and machinery, and not any decrease in market value from whatever cause arising. The allowance is in the absolute discretion of the Commissioners, and is made by way of a percentage on the value of the machinery and plant. The rate usually allowed is 5 per cent, but higher rates are allowed in many districts on various kinds of machinery. The allowance is calculated on the value of the plant and machinery at the commencement of the year, and not on any additions that may have been made during the period. The total allowance made over a number of years will not be permitted to exceed the total value of the property; but if the profits of a year are not sufficient to permit of the deduction in full of the allowance for that year, the balance may be carried forward to following years and go to relieve the assessment then.

At the foot of page two of the return is a form for making a claim to an allowance from the gross income in respect of life insurance premiums. The allowance is the amount actually paid provided it does not exceed one-sixth of the total income returned, which is the maximum allowed.

On the third page of the return is the form on which the taxpayer must make any claim to exemption or abatement by reason of his income being either below £160 or between £160 and £700. There is also a form to be completed when a claim is made to be assessed at 9*d.* in the £ on the ground that all or part of the income is earned. This claim must be made before 30 September in each year, and is allowed to individuals only.

If the income of the taxpayer is partly earned and partly unearned, any abatement to which he is entitled, either in respect of life insurance premium or because his total income is below £700, will be deducted from the earned portion of the income, leaving the tax to be paid at the higher rate on the unearned portion. Thus, assuming a taxpayer to earn a salary of £400 per annum and to have an income from investments of £80 per annum, he will pay tax on the following basis, assuming that he pays life insurance premiums of £70 per annum :—

Earned income		£400
Less Abatement on total income of £480	£150	
" Life insurance premiums ...	70	
		220
Tax payable at 9*d.* in the £ on		£180
Tax payable at 1*s.* 2*d.* in the £ on unearned income		80
Net taxable income		£260

Page four of the return contains two forms of declaration, the first to be made in partnership cases as to the constitution of the firm, division of profits, &c., and the second in cases where the business is carried on in more than one district, or where the trader resides in a different district from that in which he trades.

APPEALS

The return for assessment is required to be completed within twenty-one days, and has to be returned to the assessor for submission to the Commissioners. Notice of the assessment is sent to the taxpayer in the summer or autumn of the year, and if the amount is the same as that included in the return nothing further need be done by the trader until he receives a demand for payment.

If the amount of the assessment is higher than the return, it will be necessary to appeal if the trader desires to obtain a reduction. The appeal lies to the District Commissioners or to the Special Commissioners, but it is comparatively rare for an appeal to go to the length of a hearing before either body. As a rule an arrangement can be made with the Surveyor of Taxes for the district. The usual course is for the taxpayer to attend, either personally or by a professional accountant, with the accounts upon the basis of which the return was made. These are discussed with the Surveyor, and an agreement can generally be reached as to the amount of the assessment. If an agreement is not arrived at, and the taxpayer is still dissatisfied

with the amount of the assessment, he must give ten days' notice in writing of his intention to carry his appeal to the Commissioners. It is usual for appeals to be conducted by the taxpayer's accountant, who must be a member of a recognized association, and whose certificate of profits is practically always accepted by the Commissioners. The points on which differences arise are principally the adequacy of the allowances for wear and tear and bad debts. As previously mentioned, the wear and tear allowance on plant and machinery is made by way of percentage on the value, the rate being in the absolute discretion of the Commissioners. If he so desires, the taxpayer may charge the actual cost of the replacement of plant instead of a wear and tear allowance, and in some businesses this is an advantage to a manufacturer. The Commissioners, after hearing the taxpayer and his representative, make the assessment. There is no appeal from their decisions on questions of fact, such as the adequacy of the allowance for wear and tear and bad debts; but the taxpayer may appeal from their decision if he thinks or is advised that it is wrong on a point of law, and the ultimate decision in that event will lie with the House of Lords.

THE ESSENTIALS IN RETURNS AND APPEALS

The first essential to making Income Tax returns and successfully appealing against excessive assessments is a proper system of bookkeeping which will enable accounts to be prepared capable of being certified as correct by an accountant. There is no power to compel a trader to produce his books to the Surveyor or the Commissioners, and where the accounts are certified by a professional accountant they are not usually asked for. In cases where their production is required by the Commissioners or Surveyor a bad impression would be created by a refusal, and it would probably result in the Commissioners declining to reduce the assessment. Accounts produced to the Commissioners in support of an appeal may be required to be verified on oath.

In the case of a firm it was permissible before 1907 for partners to be separately assessed on their respective incomes from the partnership, but this course is not now allowed. The amount of income on which the charge is made is that of the firm, but the partners are allowed separate treatment for the purpose of claiming relief in respect of exemption or abatement. To obtain this relief the form on page three of the return must be completed. Thus in the case of a firm whose profits amount to £15,000, shared by five partners in the proportions of $\frac{2}{5}$, $\frac{4}{15}$, $\frac{1}{5}$, $\frac{1}{10}$, and $\frac{1}{30}$, the following table shows how the tax would be borne by the partners, assuming that they have no income from other sources:—

Partner.	Proportion of Profits.	Amount of Share of Profits.	Amount of Abatement.	Amount on which Tax Payable.	Rate of Tax Payable.	Amount of Tax.		
		£	£	£		£	s.	d.
A	$\frac{2}{5}$	6000	Nil	6000	1/2 on 3000 1/8 on 3000	425	0	0
B	$\frac{4}{15}$	4000	"	4000	1/2	233	6	8
C	$\frac{1}{5}$	3000	"	3000	1/	150	0	0
D	$\frac{1}{10}$	1500	"	1500	9d.	56	5	0
E	$\frac{1}{30}$	500	150	350	9d.	13	2	6
						877	14	2

In the absence of any request by the partners for separate treatment, tax would be charged on £15,000 at 1s. 2d., and super-tax at 6d. on £12,000, being the excess over £3,000, making the total tax £1,175, which would be borne by the partners in proportion to their shares of the profits.

When one or more partners in a firm, as in the above case, claim exemption, abatement, or the lower rate on their share of profits, it is necessary to make adjustments in the firm's accounts in order to give effect to the relief they obtain; otherwise they will bear a proportionate part of the tax paid by the firm as a whole. Thus, in the case illustrated above, the tax of £877, 14s. 2d. would, in the absence of any adjustment, be borne by the partners as shown below, with the results indicated so far as the individual partners are concerned:—

Partner.	Share of Profits.	Amount of Tax borne in the absence of Adjustment.			Income Tax actually Payable on Share.			Undercharged in Firm's Accounts.			Overcharged in Firm's Accounts.		
		£	s.	d.	£	s.	d.	£	s.	d.	£	s.	d.
A	$\frac{2}{5}$	351	1	8	425	0	0	73	18	4			
B	$\frac{4}{15}$	234	1	1	233	6	8				0	14	5
C	$\frac{1}{6}$	175	10	10	150	0	0				25	10	10
D	$\frac{1}{10}$	87	15	5	56	5	0				31	10	5
E	$\frac{1}{30}$	29	5	2	13	2	6				16	2	8
		877	14	2	877	14	2	73	18	4	73	18	4

The overcharges shown above are due to the Income Tax paid having been debited in the Profit and Loss Account as an expense of the business, and therefore borne by the partners in the same proportion as other expenses. The relief obtained is a benefit accruing to the partners personally and not to the firm, and they, therefore, are entitled to the allowances. The necessary adjustment can be made by means of the following journal entry, the effect of which will be to make each of them bear the proportion of the firm's tax to which he is liable:—

		£	s.	d.	£	s.	d.
	A's Drawing Account ... ... *Dr.*	73	18	4			
	To B's Drawing Account				0	14	5
	" C's " "				25	10	10
	" D's " "				31	10	5
	" E's " "				16	2	8
	Transfers to adjust Income Tax Payable.						

Another method of dealing with the tax is to debit it to an Income Tax Account when it is paid, and then to transfer it to the partners' respective drawing accounts, each partner being charged with the amount of tax for which he is personally liable. This of course involves the omission of Income Tax from the Profit and Loss Account, and for this reason the first method is the more desirable.

Refund of Tax

In the case of a business being discontinued the taxpayer is allowed to claim a refund of tax if he can show that the actual profits for the three years preceding the discontinuance are less than the amount on which he has been assessed. In such a case tax is payable on the actual profits only, and a refund can be obtained of the excess amount paid. When making a claim to refund on this ground a statement similar to that shown above for making a return for assessment should be prepared in support of the claim to show the actual taxable income.

Taxpayers whose incomes arise from investments and do not exceed £700 should always claim repayment of tax on the abatements to which they are entitled. Tax is deducted by companies before paying dividends, and the shareholders receive only the net amount. A taxpayer who receives an income of, say, £350 from interest or dividends on stocks is entitled to a refund of tax on £160, the amount of his statutory abatement.

A form upon which to make a claim for refund can be obtained from the Income Tax Claims Branch of the Inland Revenue Department, Somerset House, or from the local Surveyor if no previous claim has been made. Any claim made subsequently to the first application must be on a form obtained direct from Somerset House.

It is necessary to give full particulars of the stocks from which the income is derived, and to forward with the form of claim the dividend notices received from the companies which have deducted the tax. These notices are usually detachable from the dividend warrants and bear a certificate by the secretary of the company that tax has been paid to the Revenue by the company. Some dividends are stated by companies to be paid free of Income Tax. This is somewhat misleading. It merely means that tax has been paid by the company on all its profits, and that in paying a dividend to the shareholders the company

has paid the full percentage of dividend without charging the individual shareholders with their proportions of the tax. Refund is still obtainable on the abatement to which a taxpayer is entitled owing to his income being under £700.

Refund of tax overpaid may also be claimed if the taxpayer has omitted to claim an allowance in respect of life insurance premiums, either by oversight, or owing to a new policy having been taken out since paying tax for the year. A claim form should be obtained from the sources mentioned above, and full particulars of the policies held and premiums paid inserted in the spaces provided. In the case of a claim under this head full particulars must also be given of the earned income of the claimant, as any refund will be at the earned rate if tax has previously been paid at that rate. The refund allowed will not in any case exceed the tax on a sum equal to one-sixth of the whole net income of the claimant.

Refunds are made by money orders issued from the Claims Branch at Somerset House, and payable at any Money Order Office selected by the claimant.

CHAPTER IX

FALSIFICATION OF ACCOUNTS

Introductory—Falsification by Servants—Objects of a Balance Sheet—Valuation of Stock—Position of Auditors—The Common Cause of Fraud—Defalcations of Cashiers, &c.

INTRODUCTORY

In all matters of account, truth and accuracy are of the highest importance, not only to the proprietors of any particular business, but also to the general public. Falsification of accounts and consequential inaccuracies, if undiscovered, are bound to lead to the production of statements which will mislead, in the first place, the proprietors, and, in the second place, the public, should the latter on the strength of such statements be invited to subscribe money in order to acquire financial interest in the business. The subject, indeed, becomes every year more important owing to the multiplicity of public companies, and the facilities which the law now provides for converting private concerns into joint-stock enterprises, a subject which is treated in other connections.

FALSIFICATION BY SERVANTS

So many serious losses have resulted from the falsification of accounts that the legislature has made provision for severe punishment to be inflicted on the guilty parties when convicted of such an offence. The Falsification of Accounts and False Balance Sheets Act, 1875, declares:

"That if any clerk, officer, or servant, or any person employed or acting in the capacity of a clerk, officer, or servant, shall wilfully and with intent to defraud, destroy, alter, mutilate, or falsify any book, paper, writing, valuable security, or account which belongs to, or is in the possession of, his employer, or has been received by him for and on behalf of his employer; or shall wilfully, with intent to defraud, make or concur in making any false entry in, or omit or alter, or concur in omitting or altering, any material particular from, or in, any such book, or any document or account, then in every such case the person so offending shall be guilty of a misdemeanor, and be liable to be kept in penal servitude for a term not exceeding seven years, or be imprisoned with or without hard labour for any term not exceeding two years".

The Larceny Act, 1861, and the Companies (Consolidation) Act, 1908, also contain provisions for the punishment of directors, managers, or any other persons found guilty of wilfully making, circulating, or publishing false statements, accounts, or balance sheets.

Deliberate falsification must be distinguished from incompetency or mere neglect to keep proper accounts, although all or any of these may lead to the production of inaccurate or false statements. Falsification is a positive offence, while incompetency or neglect is an offence of a negative character and is unpunishable, unless the neglect results in injury or loss to others, as in the case of a bankrupt. In such a case, failure to keep proper books of account may result in loss to the creditors, and is neglect which is taken into consideration by the Court on an application by the bankrupt for his discharge. (See Part III, Chapter XI.)

OBJECTS OF A BALANCE SHEET

Some of the most serious and far-reaching frauds upon the public have been perpetrated by means of false balance sheets; but before discussing the methods by which the falsification is effected it is necessary to consider the objects of a balance sheet, and what in effect it really is or purports to be. (See also Chapter IV of this Part.) Every balance sheet which is prepared in order to show the position of a business on a given date may serve two purposes—

(*a*) To furnish information to the proprietors,
(*b*) To induce members of the public to become proprietors.

It is a collection, in a summarized and convenient form, of the balances of all accounts open in the ledger of a concern on a given date, and as a general rule it is not, and does not purport to be, anything more. It is rarely, if ever, a document containing nothing but statements of facts so far as money values are concerned. In this respect a balance sheet should be regarded as a statement partly of facts and partly of opinions. Statements of fact are those which relate to the balance of cash in hand, or at the bank, or the amount due to creditors; statements of opinion are those which relate to the values of the book debts, the stock-in-trade, machinery, premises, &c.

In examining an audited and certified balance sheet it should be borne in mind that an auditor is not a valuer, and that it is no part of his duty to certify the correctness or otherwise of the values placed upon all or any of the assets of a concern. What he does is to certify the agreement of the balance sheet with the books and other documents which he is called upon to examine.

An audited and certified balance sheet, although perfectly true as to matters of fact, may nevertheless be false as to matters of opinion, e.g. stock, book debts, goodwill, &c.; and it is a significant fact that some of the most notorious cases of falsification of balance sheets have related to matters of opinion, as to which the auditors could not strictly be held responsible.

A balance sheet may be false by understating the amount of liabilities or by overstating the value of the assets. An understatement of liabilities would ordinarily involve the omission of entries in the books of account, as where a person is liable in damages to another person and fails to enter the amount of such liability in his books; or where bills of exchange have been negotiated and dishonoured and the liability to the holder is omitted.

VALUATION OF STOCK

One of the most important items in the accounts and on the assets side of a balance sheet of any trading concern is the stock-in-trade. (See also other chapters of this Part.) According to the method of valuing this item the profits of a business may be shown to be great or small and the balance sheet favourable or unfavourable. A simple example will suffice to prove the truth of this statement. Let us suppose that a man starts business with stock of the value of £100 and buys goods at a cost of £300, making £400 in all. Suppose also that he sells one half these goods for £250—clearly his profit would be £50, which would be shown in his trading account thus:—

TRADING ACCOUNT (1)

	£	s.	d.		£	s.	d.
To Stock at commencement.....	100	0	0	By Sales.....	250	0	0
" Purchases.....	300	0	0	" Stock at cost price.....	200	0	0
" Balance, being Gross Profit.....	50	0	0				
	450	0	0		450	0	0
				By Gross Profit.....	50	0	0

Now, let us assume that, instead of valuing his stock at the end of the period at £200, he improperly values it at £400. His stock would thus be overvalued to the extent of £200 and his profits would be inflated to the same extent, as will be seen by the following:—.

TRADING ACCOUNT (2)

	£	s.	d.		£	s.	d.
To Stock at commencement.....	100	0	0	By Sales	250	0	0
" Purchases.....	300	0	0	" Stock	400	0	0
" Balance, being Gross Profit....	250	0	0				
	650	0	0		650	0	0
				By Gross Profit	250	0	0

And not only will the profit be overstated to the extent of £200, but the assets appearing in the balance sheet will be overstated in value to a corresponding extent, for amongst the assets stock-in-trade will be shown as of the value of £400 instead of £200.

This kind of falsification has not, however, a cumulative effect as regards profit. That is to say, an overvaluation of stock to the extent of £200 every year for ten years would result in a repetition each year of a false statement of the value of stock on hand, but would not result in a repetition of a false statement of profit. For example, if we continue our illustration and assume that in the following year the purchases amount to £200 and half the goods were sold for £250, the profit would again be £50, as is shown by the following, which we may call our true trading account:—

(TRUE) TRADING ACCOUNT

	£	s.	d.		£	s.	d.
To Stock at commencement, as per Trading Account (1).....	200	0	0	By Sales	250	0	0
" Purchases.....	200	0	0	" Stock	200	0	0
" Balance, being Gross Profit.....	50	0	0				
	450	0	0		450	0	0
				By Gross Profit.....	50	0	0

Now, let us take the false figures and assume that at the end of the second year the stock is again overvalued to the extent of £200. We then get the following result:—

(FALSE) TRADING ACCOUNT

	£	s.	d.		£	s.	d.
To Stock at commencement, as per Trading Account (2).....	400	0	0	By Sales	250	0	0
" Purchases.....	200	0	0	" Stock	400	0	0
" Balance, being Gross Profit.....	50	0	0				
	650	0	0		650	0	0
				By Gross Profit.....	50	0	0

The truth is, that whatever temporary advantage a man may gain by inflating the value of his stock-in-trade at the end of one year, he will lose at the end of the next year through having to charge his trading account with the inflated amount of stock brought forward at the beginning of the period, and unless the overvaluation is repeated the effect on the trading account will be disastrous, as is shown by the following example:—

Photo. Valentine

BIRMINGHAM UNIVERSITY TECHNICAL AND COMMERCIAL SCHOOLS

Photo. Banks

MUNICIPAL SCHOOL OF TECHNOLOGY, MANCHESTER

TRADING ACCOUNT

Showing inflated value of stock brought forward at the commencement of the period, but the true value brought into account at the end of the period.

	£	s.	d.		£	s.	d.
To Stock at commencement, as per Trading Account (2)	400	0	0	By Sales	250	0	0
" Purchases	200	0	0	" Stock at cost	200	0	0
				" Balance, being Gross Loss	150	0	0
	600	0	0		600	0	0
To Gross Loss	150	0	0				

Such an account would in the ordinary course of things lead to enquiries which, if pursued far enough, would disclose the fact that at the end of the previous year the stock was overvalued to the extent of £200, that the profit was inflated to a like extent and was therefore false, and that the balance sheet was false by reason of the stock-in-trade being shown therein as of the value of £400 instead of £200.

All these consequences may result from a determination to value the stock on a true basis when its value has been previously inflated by adopting a false basis, e.g. selling price instead of cost price. Therefore, when falsification of accounts by overvaluing stock-in-trade is once begun, there is a strong temptation to continue the falsification; and if it remains undetected there exists the further temptation to increase the inflation in order to show increasing profits, for the correctness of the profits shown in the accounts of a trading concern depends largely (and sometimes entirely) upon the correctness of the value at which the stock has been taken. In fact, the valuation of the stock may be regarded as the pivot upon which rests the accuracy or otherwise of the profit shown in a trading account.

POSITION OF AUDITORS

The question may now be asked: How can the falsification of stock values be prevented? Before attempting to answer this question let us consider the auditor's position in relation to this subject. As already stated he is not a valuer, and he does not certify the value of any asset. He certifies that the balance sheet agrees with the books and documents of the undertaking, and with the information supplied to him by responsible persons; and as regards all questions of value he is entitled, in the absence of suspicious circumstances, to rely upon the statements made to him by trusted officers.

This principle was laid down in the well-known case of the *Kingston Cotton Mill Company, Ltd.*, No. 2 (1896), the manager of which had deliberately exaggerated the quantities and values of cotton and yarn held by the company at the end of each of several years. A stock book was kept to record the details of stock on hand at the date of each balance sheet. These details were summarized, and the summary was signed by the manager. The auditors checked the totals of the various groups of items on the summary, but did not check the accuracy of the items summarized. Upon an appeal against an order of Court holding the auditors liable to make good to the company moneys improperly applied in payment of dividends on the faith of certain balance sheets which they had signed, it was held that the auditors were not liable. It was no part of an auditor's duty to take stock; he must rely on some other person for the details of it, and for the materials to enable him to enter it at its proper value in the balance sheet. If the auditors had gone more fully into all the books relating to stocks of cotton and yarn the fraud would probably have been discovered; but the question was: Were the auditors wanting in reasonable care in not thinking it necessary to test the managing director's returns? In the absence of any suspicious circumstances they were not. They were watchdogs, not bloodhounds. They were justified in believing tried servants of the company, in whom confidence had been placed by the company, and they were not to be made liable for not tracking out ingenious and carefully-laid schemes of fraud where there was nothing to arouse their suspicion, and where such frauds remained undetected for years by the directors of the company.

Therefore, in the absence of suspicious circumstances, all that an auditor is bound to do, so far as stock values are concerned, is to obtain a proper certificate from the managing director or other trusted official of the company. But while this

may be sufficient to protect the auditor against liability should the values subsequently be proved to be false, it is open to question whether it is sufficient to protect the public against loss through false returns. Indeed it has been clearly demonstrated that in certain cases it is no protection whatever to the public against the fraudulent schemes of unscrupulous persons. To afford proper protection to the public some alteration in the present practice is obviously needed.

THE COMMON CAUSE OF FRAUD

An examination of the most notable frauds in recent years will reveal one outstanding fact, viz. that they have been the result of placing too much confidence in one man, and allowing that man to have absolute control over operations of an important and far-reaching character. Take, for example, three cases within the memory of every business man, viz. the Millwall Dock, Whitaker Wright, and Measures.

In each of these cases too much reliance was placed upon one man, with the result that a criminal offence was committed (perhaps under very strong temptation), which otherwise would have been much more difficult. Therefore, in order to prevent frauds of this class, it would seem that no one man should be allowed to certify year after year the value of book debts or stock-in-trade, or be allowed to manipulate uncontrolled the financial operations of a group of companies. With regard to the falsification of stock values, the public could be better protected from loss through this kind of fraud if the position of auditors were strengthened so that they could fearlessly refuse to accept the certificate of the same man for more than, say, three consecutive years without some corroboration such as that of an independent valuer.

DEFALCATIONS OF CASHIERS, ETC.

So far we have dealt only with falsification of accounts brought about by the manipulations of persons holding highly important and responsible positions. There remains to be considered that kind of falsification which is brought about by the defalcations of cashiers, travellers, collectors, and bookkeepers.

In the case of cashiers many frauds have been committed when one man has been permitted to have complete control of all records of cash received and paid and to make entries in other books of account. Where a cashier is allowed to receive money and hold it for an indefinite time, and use it, if necessary, to pay accounts, &c., and at the same time has unrestricted access to the ledgers in which he may make entries, there is ample opportunity to falsify the accounts if the person be so minded.

It is easy in such circumstances for a man who is bent on fraud to receive money from a customer, misappropriate it, make no entry in his cash book, but enter the amount to the credit of the customer's account in the ledger. Such a simple fraud would, of course, be quickly discovered by the auditor. Suppose, however, that the circumstances are such that the cashier is in a position to prevent any record of the debt appearing in the ledger, or to manipulate the entries so as to show in the customer's account a smaller amount than that actually due, the misappropriation would not be discovered by merely checking the postings from one book to another. Of course it would be necessary in such a case for the cashier to keep his own private record of the real transaction, in order that he may correctly render the customer's account.

Fictitious Entries

Even when the cashier has nothing to do with the customers' ledger but is allowed to control the entries in the creditors' or bought ledger, fraud may be committed if the person is so inclined. For example, he may enter a fictitious purchase in the purchase book, post the amount to a real or fictitious account in the ledger, make a fictitious payment of the amount, and misappropriate the money. The books will appear to be in order, the only missing document being the invoice for the goods fraudulently entered as purchased; but a desperate man will not scruple to supply a fictitious invoice.

In either of such cases as the above the fraud will probably not remain long undetected, for an auditor can supply a very simple and effective method of testing the accuracy of the accounts in any ledger in reference to which there is the slightest suspicion of falsification. It is worth while, however, to consider by what means the falsification can be prevented.

Rules for Cashiers

To obviate frauds of this kind it is advisable to

lay down strict rules to be observed by the person who is responsible for keeping a proper account of all cash received and paid, such as the following:—

1. All cash, cheques, &c., received to be forthwith entered in the cash book and paid into the bank.
2. All receipts to be issued from a specially printed counterfoil receipt book.
3. Vouchers to be obtained for all payments, if possible.
4. All payments of £2 and upwards to be made by cheques.
5. All payments of sums less than £2 to be made out of petty cash.
6. The petty cash book to be examined with the vouchers at least once a month, and a cheque drawn for the total amount of disbursements.
7. All wages and salaries sheets to be certified as correct by a responsible person before the payments are made.
8. The balance at the bank as shown by the cash book to be periodically agreed with the balance as shown by the bank passbook, and in case of disagreement a reconciliation statement to be prepared and entered in a book provided for the purpose.
9. The cashier to have nothing to do with posting to the ledgers or with the rendering of statements of account to customers.

Special attention should be given to the system of calculating and paying wages, so as to prevent fictitious payments to imaginary workmen. It is advisable to distribute the work of calculating, checking, entering, and paying amongst several clerks, care being taken that the person who actually pays the wages has had nothing to do with the preparation of the wages sheets.

Petty thefts may be made by the person who keeps the petty cash, and it is therefore important to have a regular and effective means of checking the petty-cash payments. (See Chapter I of this Part.)

Defalcations of Travellers

To prevent defalcations by travellers and collectors it is advisable that all travellers or collectors should be furnished with a list of all outstanding accounts which they are to collect. At the same time counterfoil receipts should be prepared and handed to each traveller or collector, who at the end of the week must account for the cash or return the counterfoil receipt.

Another kind of theft is where a man employed in the warehouse is in league with a customer to whom a larger quantity of goods is supplied than is charged on the invoice. This can be easily prevented by a system by which the work of forwarding the goods is done by persons independent of the selling department. In the forwarding or packing department the goods should be carefully checked with the delivery note or invoice and any discrepancies should be noted, and the attention of a responsible person drawn to the fact.

In retail businesses thefts sometimes occur, and owing to the multiplicity of transactions are often difficult to detect. Indeed, sometimes this kind of peculation defies detection, and the only remedy is to discharge the whole staff in a particular department. An easy method of fraud is to sell an article, receive the money over the counter, make out the bill for a smaller amount, pay in the smaller amount and appropriate the difference. Where no change is required by the customer he will not wait for the bill, and in the absence of proper supervision this kind of theft may continue for some time without detection. To avoid fraud of this kind it is necessary to have every bill initialled at the time, so as to render falsification both difficult and risky.

Internal Check System

In all businesses it is advisable to adopt a system of internal check. An internal check is that part of the organization of bookkeeping which provides for a regular and systematic check on the accuracy of the financial records so as to secure the speedy detection and rectification of errors, and at the same time minimize the possibility of fraudulent entries being made.

The following are some of the rules which should be observed:—

1. All cash received should be paid into the bank daily, and all payments other than petty cash payments (which should be kept on the imprest system) should be made by cheques.
2. The cashier should not be allowed to make entries in the ledgers.
3. The balance at the bank as per the bank passbook should be regularly agreed with the cash book, and a reconciliation statement prepared when necessary.
4. All postings to the ledgers should be called over daily, if possible, by clerks who have not made any of the entries.
5. All invoices should be compared with the orders and goods received books, and initialled by the manager. The calculations and totals will then be checked in the office before the invoices are entered in the purchases book.
6. The calculations on all invoices sent out should first be checked by the entering clerk before being entered in the sales book.
7. All ledgers should be rendered self-balancing, and the ledgers should be periodically checked by means of the summary books or test journals.

CHAPTER X

THE INVESTIGATION OF ACCOUNTS

Introductory—The Introduction of a Partner—The Acquisition of a Business—The Conversion of a Business—Suspected Fraud—Claims for Compensation—The Falling off or Loss of Trade.

INTRODUCTORY

The scope and method of an investigation of accounts must largely depend upon the nature of the business whose accounts are to be investigated and the objects of the investigation. An examination of accounts with the object of ascertaining the existence or absence of fraud would not be conducted on the same lines as one designed to test the accuracy or otherwise of alleged profits, nor would the method of enquiry suitable to a very large retail establishment be appropriate to a purely financial business.

It is necessary, therefore, to consider this subject in relation to the various purposes for which investigations are usually conducted, and for the purposes in view trading concerns may be taken as furnishing the most common and therefore the most useful examples. At the same time special points in relation to undertakings of a non-trading character will be dealt with.

The events which most frequently give rise to the necessity for an investigation of accounts are as under:—

1. The introduction of a partner.
2. The acquisition of a business.
3. The conversion and sale of a business to a limited company.
4. Suspected fraud.
5. Claims for compensation for the removal of a business.
6. The falling off or loss of trade.

It will be convenient to consider separately the methods to be adopted in each case.

THE INTRODUCTION OF A PARTNER

There are, of course, many cases in which the relations between the proprietors of a business and a prospective partner are such as to render any investigation of accounts unnecessary. The proposed partner may, for example, be a near relative of one of the proprietors, or he may have been associated with the management of the business for many years.

On the other hand, there are numerous cases in which the proprietors of a business and a prospective partner are complete strangers, and in which an independent investigation of accounts on behalf of the proposed partner is not merely advisable, but, in the majority of cases, is absolutely essential if disappointments and financial losses are to be avoided. An unsuspecting and inexperienced person who possesses capital can easily lose every penny of it by entering into partnership with a stranger or strangers, unless he takes the precaution to secure the services of a competent accountant to investigate and report upon the financial position and prospects of the business.

Very glowing indeed are the statements sometimes made in order to tempt the unwary stranger, who is often liable to be too favourably impressed with showy appearances, such as a well-furnished office, busy clerks, &c. To convince him that everything is perfectly *bona fide* and in order the books

of account are produced, and he is invited then and there to satisfy himself that the business is all that it is represented to be. In the majority of cases it would be very difficult, if not impossible, for anyone to arrive at a sound and satisfactory conclusion as to the financial position of a business by an inspection of books during the space of a few minutes. It often happens, however, that the mere offer of inspection, accompanied, as it usually is, by a great show of frankness, achieves its object, and the stranger without further enquiry or independent advice enters into arrangements which in nine cases out of ten he very soon regrets.

It has been seen elsewhere that there are now two kinds of partnerships, viz.: (1) General partnerships; (2) Limited partnerships. (See Part III, Chapter III.)

It is important to remember the distinction between the two kinds. A general partnership is one which consists of persons whose liability for the debts and obligations of the firm is unlimited. A limited partnership is one which consists of one or more general partners whose liability is unlimited, and one or more limited partners whose liability is limited to the amount of capital contributed by them. A person may, therefore, under the Limited Partnership Act, 1907, contribute capital to a firm and receive a share of the profits without being liable for the debts and obligations of the firm beyond the amount of his contribution. A limited partnership must, however, be registered with the Registrar of Companies, otherwise it will be deemed to be a general partnership and every limited partner a general partner.

A limited partner may not take part in the management of the business, and if he receives back directly or indirectly any part of his capital, he is liable for the debts and obligations of the firm to the extent of the amount withdrawn.

An investigation on behalf of a prospective partner involves not only an examination of accounts in order to ascertain the facts concerning the financial position and prospects of the business, but also a careful consideration of the objects of the proposed partnership, and how far those objects are likely to be achieved if the partnership is entered into. Indeed these objects must be considered concurrently with any investigation of accounts that may be made.

The Objects of Securing a Partner

The reasons for seeking a partner are various, but for present purposes we may assume that the objects are one or both of the following:—

(1) To obtain further capital;

(2) To secure the services of the prospective partner.

If the object is merely to secure further capital, the investigation should be directed towards ascertaining how much of the further capital is required to pay off existing, and perhaps pressing, liabilities and how much will be available for developing and extending the business.

The mere fact that capital is required to meet pressing liabilities may be favourable or unfavourable according to circumstances. A man may commence business with a small amount of capital; the business may grow out of proportion to the capital originally invested, and, owing to the fact that he is obliged to give longer credit than he himself can obtain, he may gradually get behind with his payments and his creditors may become impatient. In such circumstances the business may be quite sound and in a condition to justify the introduction of fresh capital, which may not only strengthen the finances of the business, but enable the proprietors to secure better terms as to prices and discounts.

On the other hand, the finances of a business may have got into a bad state as the result of bad trade, mismanagement, &c., and even if the pressing liabilities were met the business would perhaps still remain in an unsound condition.

When the object is to obtain fresh capital for the purposes of developing and extending the business, it will be necessary to consider whether the position and character of the business are such that it is capable of being developed, and whether the capital sought is sufficient for the purposes of such development. The ascertained profits from year to year will show whether the business is a growing one or otherwise. If the profits are increasing, the question will arise as to whether the probable rate of increase is sufficient to justify the introduction of the additional capital required.

If the objects of the proposed partnership are not only to obtain capital but also to secure the services of the prospective partner, care must be taken to ascertain that the qualifications and experience of the latter are such as will enable him to take a useful and prominent part in the management and control of the business. It is a risky thing for a man to undertake active partnership in a business of which he knows practically nothing, for in that case he risks not only the loss of his capital but also the loss of his self-respect, since he may become a nonentity in a concern in which he has a considerable sum at stake. It is a common pretext of those possessed of a small or effete business to offer a salaried position to secure capital. In such cases there is rarely any need for a

partner, nor scope for his abilities if he have any —it is money alone that is wanted.

The Scope of the Investigation

The investigation of the accounts should generally cover a period of four or five years—assuming the business to have been so long established. The trading and profit and loss accounts and balance sheets should be carefully tested for the purpose of ascertaining—

(*a*) That all the purchases have been entered in the books and brought to account.

(*b*) That all the sales recorded in the books are genuine.

(*c*) That all the expenses of carrying on the business have been correctly entered and charged against the profits.

(*d*) That the stock-in-trade has been regularly taken on a sound and consistent basis.

(*e*) That proper allowances have been made for the depreciation in value of fixed assets such as leases, plant, machinery, fixtures, furniture, &c.

(*f*) That the book debts are genuine and are likely to be recovered.

(*g*) That assets such as goodwill, patents, copyrights, &c., are valued on some reasonable basis, and are not shown in the balance sheet at fictitious or arbitrary valuations.

Other matters may call for investigation according to circumstances, but the above points may serve as an indication of the general character of the principles to be followed.

The Real Tests of Accuracy

It is important to remember that the bare fact that books of account are arithmetically correct, in so far that they are capable of being balanced to a penny, is not conclusive evidence that they contain a full and correct record of all the facts which ought to be recorded, or that they do not contain false entries. Therefore, in the conduct of an investigation one must look beyond mere arithmetical accuracy, which is not inconsistent with falsity of fact. The real tests are to be found in the answers to the questions:—

1. Is all that is recorded true?
2. Is all that is true recorded?

These questions refer not only to entries of transactions which are matters of fact, but also to entries of values of assets, which are generally matters of opinion.

If a man purchases £100 worth of goods for his business and pays for them out of private sources, and omits to record in the books of his business either the purchase of the goods or the payment of the money, the effect will be to show a fictitious profit at the end of the period. If the value of the goods is duly entered in the books either as stock or as a sale, the whole amount so entered will be brought to credit as profit, since there will be no entry on the other side of the account relating to the cost of the goods. Here we have an example of an unrecorded fact which does not affect the balancing of the books, but materially affects the financial results as disclosed thereby. There is no false entry, but an omission to enter facts which ought to be recorded.

The question naturally arises: How can such omissions be discovered? In the first place there must be reasonable ground for suspecting that such entries have been omitted before embarking on a voyage of discovery. The usual percentage of gross profit on sales is well known amongst accountants who have to examine the accounts of various businesses. If in a particular case the profits appear to be abnormally large having regard to the character of the business, there would be grounds for enquiry as to the cause; and if the enquiry produced unsatisfactory answers there would be grounds for suspicion, which would lead to further enquiry into the system of purchasing, receiving delivery of, and entering goods. If the system was found to be such as would lend itself to the suppression of invoices and the omission of entries, the enquiry might be pursued to the extent of asking all firms from whom goods had been purchased to render copies of their accounts covering the period under investigation. This would probably lead to the discovery.

Valuation of Book Debts

Fictitious entries relating to "sales", e.g. entering goods as sold and charging them in the accounts of imaginary persons when, in fact, no sales have taken place and no goods left the premises, would also have the effect of inflating the apparent profits of a business, but the real nature of the entries would probably be discovered by examining the character and value of the book debts. In determining the value of book debts there are certain points which should be kept in view. Regard must be had to the usual terms of credit allowed; to the length of time the debts have been owing; to the manner in which the accounts have been rendered—whether regularly or irregularly; to the habits of the debtors as regards regularity of payment; to the character of the balances alleged to be owing—whether any part of them is composed of old balances, disputed items, empties, discounts deducted but disallowed, &c. Care must also be taken to see that the alleged debts do not represent the value of goods sent on "sale or return", or

include trade discounts; and if payments are made by means of bills of exchange the accounts should be examined to see that the bills are usually met. It is only by a careful consideration of the financial habits of each debtor that the value of book debts can be fairly estimated. The genuineness or otherwise of the book debts depends partly on the *bona fide* character of the entries of sales, but not entirely, since the sales may have been correctly entered but the debts may be irrecoverable owing to the financial misfortunes of the debtors.

Various Matters for Investigation

Expenses are often paid out of private moneys, or passed through the books and charged to Drawings Account instead of to Profit and Loss Account. Stock is sometimes taken at cost price at the beginning of a period and at selling price at the end of the period, thus showing a profit which has not been made. This could be detected by comparing stock items and prices with invoices. The omission to allow for the depreciation of fixed assets would be *prima facie* evidence that the assets were overvalued in the accounts. Items such as goodwill are sometimes valued at arbitrary figures in order to show an improved financial position. The value of goodwill, if it exists, can only be assessed in the light of definite information as to the nature, position, and profits of a business. If a prospective partner is asked to make a payment on account of his share of the goodwill, an investigation concerning its value will usually be made. (As to Goodwill, see other references in this Book.)

Goodwill may have been created by: (1) personal skill and influence; (2) securing a monopoly either as to the place of business or as to the articles produced; or (3) acquiring a good reputation as regards the quality and price of goods supplied. Goodwill is usually valued on the basis of the average profits for a term of from three to five years; but when the goodwill is based upon personal skill and influence, as in the case of a doctor or other professional man, the value will depend upon how far the change of proprietorship is likely to affect the amount of business.

In reporting to a client the result of an investigation such as that outlined above, care should be taken to state clearly the matters which have been enquired into, the general method of enquiry, and the results. The report should as a rule conclude with an opinion as to whether the business proposed is to be recommended or otherwise, and it should, of course, be signed and dated.

THE ACQUISITION OF A BUSINESS

An investigation on behalf of a prospective purchaser of a business will closely follow the lines of that already described. Apart from the examination of the books of account, enquiry should be made as to the proprietor's reasons for desiring to sell the business, and as to whether the proposed purchaser possesses such knowledge and experience as are likely to enable him to carry on the business successfully. These points are obviously matters of common sense rather than matters of account.

Should a purchase of the business be decided upon, care must be taken to have a purchase agreement properly drawn up by a solicitor, in order that the purchaser may be put into legal possession of all that he intended to buy, and that he may be protected from any attempt to deprive him of the goodwill of the business.

THE CONVERSION OF A BUSINESS

The conversion of a business and sale to a limited company may not involve any change in the management of the business, but it will involve a change in the proprietorship, for although the original owners of a business may acquire all the shares in the company and may continue to manage the business, they can no longer be regarded as the proprietors of the business, since the company which has acquired it is a separate entity distinct from the persons who are its shareholders.

There are two kinds of limited companies, viz.: (1) Private companies; (2) Public companies. (See Part III, Chapter IV.)

While the great advantage of converting a business into a limited company is the limitation of the liability of the shareholders, there are many other advantages, the chief of which is that the title of the company to the business and property is not affected by any changes in the ownership of the shares.

An investigation of the accounts of a business with a view to its sale to a company will be directed to ascertaining the nature and amount of the liabilities and assets and the amount of the average profits over a period of some years. The price of the goodwill is usually based on the

amount of the average profits, and in arriving at profits certain items which may have been charged in the Profit and Loss Accounts are usually added to the net profits shown in such accounts. These items are not regarded as proper charges against revenue, but are in the nature of capital charges, e.g. interest on loans, interest on capital, partners' salaries, income tax, or capital losses, e.g. loss on sale of old machinery, plant, &c.

The method of converting a private firm into a limited company has been treated in Part III, Chapter IV.

The values of the various items of property and assets to be taken over by the company must be agreed upon, and the purchase price fixed. The purchase price to be paid by a company generally includes a sum for goodwill. All these matters are then embodied in the form of an agreement between the vendors and the company, or a nominee appointed to act for the company pending its formation.

The agreement having been entered into, the necessary entries will be made in the books of the company recording the facts relating to the purchase of the business, and the vendors' books will be closed.

The closing of the vendors' books and the opening of new books on behalf of the company must be treated as two distinct and independent operations.

The closing of the vendors' books will be effected as follows:—

1. A Realization Account will be opened. This account will be debited with the assets to be transferred, and the various accounts of assets will be credited.

2. An account will be opened in the name of the purchasing company. This account will be debited with the purchase price of the assets acquired by the company, and the Realization Account will be credited.

3. If the liabilities are to be taken over by the purchasing company, the total amount thereof will be transferred to the credit of the company's account, which will then show the net amount due from the company.

4. The Realization Account, after being charged with the expenses, will show on balance the profit or loss on realization, and such balance will be transferred to the credit or debit of the vendors' personal accounts in the proportions agreed upon between them.

5. Accounts of assets received in consideration of the sale to the company will be opened and debited with the appropriate amounts, the purchasing company's account being credited.

6. The cash, shares, debentures, &c., in hand or received from the company will be distributed in agreed proportions amongst the vendors, whose accounts will be debited therewith and closed.

The opening of the purchasing company's books will be effected as follows:—

1. An entry will be made in the company's Journal debiting accounts for the various assets acquired, including goodwill, crediting accounts for the liabilities taken over, and crediting the vendors' account with the agreed purchase price.

2. The vendors' account will be debited with the cash, shares, debentures, &c., paid and issued in satisfaction of the purchase price, and accounts of cash, shares, debentures, &c., will be credited.

SUSPECTED FRAUD

The method of conducting an investigation of accounts with the object of discovering fraud will, of course, depend upon the special circumstances of each case and the character of the fraud suspected. Fraud will generally relate to cash, cash articles or goods, and the usual methods of tracking fraud of this kind are dealt with under "Falsification of Accounts". (See Chapter IX of this Part.)

CLAIMS FOR COMPENSATION

An investigation of accounts with the object of formulating a claim for compensation for the removal of a business from one place to another, calls for the exercise of judgment and experience as well as a thorough knowledge of accounts. The claim will be based on—

(*a*) Actual expenses of removal.

(*b*) Losses incurred by reason of the compulsory sale of stock, leases, fixtures, &c.

(*c*) Loss of beneficial interest.

The accounts of the business for the previous three or four years will require examination for the purpose of ascertaining the value of the beneficial interest, which will be based upon the average net profits for a period of three or more years according to circumstances.

The actual expenses of removal will be ascertained from the removal accounts. They will include all wages and other expenses incurred during removal.

To ascertain the loss on the sale of stock, stock should be taken on the usual basis of valuation before the compulsory sale begins. The loss will then be represented by the total amount of the

difference between the stock values and the sums actually realized.

The loss on the sale of the lease will be represented by the value at which it stands in the books. To this value 10 per cent is usually added.

The loss on fixtures will be represented by their book values less any sums received on account thereof.

To these losses an additional sum may be allowed as compensation for the compulsory sale of the premises.

The necessary information having been ascertained, a form of claim will be prepared showing the nature and amount of each separate item and the total amount of the claim.

THE FALLING OFF OR LOSS OF TRADE

The reason for the falling off or loss of trade may be traceable to various causes, of which the following may be mentioned:—

1. Unfavourable weather.
2. Changes of fashion.
3. Errors of judgment in the matter of goods purchased.
4. Change of local conditions.

These are matters which can be discovered without any special investigation of accounts. They may be regarded as both real and apparent causes.

There are sometimes, however, instances in which a falling off of trade takes place without any apparent cause, and in such cases it is necessary to investigate very carefully the internal organization of the business, particularly with regard to the method of recording purchases and sales, and the method of taking and valuing stock.

The chief points are:—

1. To see that all goods delivered are entered in the accounts whether the invoices are "dated forward" or not.
2. To see that all sales are properly entered in the books whether they are sold "forward" or not.
3. To see that the stock is taken on the same basis of valuation at the beginning and end of each period.

"Dating forward" means selling and delivering goods on a certain date, e.g. 5 December, and dating the invoice as if the sale and delivery had not taken place until some later date, e.g. 5 February.

Special attention should be given to the system of forwarding goods sold, since it is possible under a defective system for goods to be delivered but not entered in the books as a result of collusion between employees and outside people. Under a sound system no goods would be allowed to leave the premises without proper authority issued from the forwarding department, which will receive from the entering room a list of the goods to be forwarded—such list being a copy of that from which the invoice will be made out and passed through the books of account.

CHAPTER XI

INSOLVENCY, BANKRUPTCY, ETC.

Introductory—Private Arrangements—Bankruptcy Statement of Affairs—Companies' Liquidation—Realization and Distribution—Reconstruction of Companies.

INTRODUCTORY

An insolvent in England has been described as—

(1) A man whose liabilities exceed his assets; and—

(2) A man who is unable to discharge his debts and obligations as they become due.

The term is used in the latter sense for commercial purposes, and when a trader is in this position he cannot long continue business. Two alternatives are possible: he may either make a private arrangement with his creditors or he may have his affairs dealt with under the machinery of the Bankruptcy Acts. (See also as to English, Scots, and Irish law, Part III, Chapter XI.)

PRIVATE ARRANGEMENTS

If a trader whose affairs become involved decides to effect a private arrangement with his creditors he usually calls them together for the purpose of laying his financial position before them and propounding a scheme for the payment or part payment of the debts. This step is only taken as a last resource to avoid bankruptcy when it is evident that it is not possible to continue trading. A course frequently adopted is to propose an assignment of the debtor's property to a trustee on behalf of the creditors, with the view of realizing the assets and distributing the proceeds *pro rata* amongst the creditors. The document by which such an arrangement is made is known as a Deed of Arrangement and requires registration. Its execution amounts to an act of bankruptcy. With the view of preventing bankruptcy proceedings it is the practice to get as many creditors as possible to become parties to the deed.

At the meeting at which the position is placed before the creditors a statement of the debtor's assets and liabilities is presented. There is no obligation on the debtor to present the statement in any particular form, and it is sometimes merely an ordinary Balance Sheet. It is, however, generally in a form known as a Statement of Affairs similar to that which has to be filed in bankruptcy proceedings. (See p. 222.) Here it may be remarked that in the event of a Balance Sheet in the usual form being produced at a meeting of creditors called to consider a scheme, full information should be obtained of all charges held by creditors on assets included in the Balance Sheet and of any other debts which may have to be paid in full. This information is necessary in order that the ordinary creditors may know the amount of the unsecured debts and what free assets there are to meet them.

BANKRUPTCY STATEMENT OF AFFAIRS

When the second alternative of bankruptcy is adopted by the debtor or is forced upon him by his creditors it becomes his duty to lodge with the Official Receiver a statement of his affairs as at the date of the Receiving Order, as fully explained in Part III, Chapter XI. The statement comprises various schedules, all of which are summarized on a front sheet, which is known as the Statement of Affairs. In some respects it resembles a Balance Sheet, but there are important points of difference, the chief of which are—

1. That the assets are valued for immediate realization, and not on the ordinary basis of a continuing business;
2. That assets charged to creditors are not included amongst the general assets;
3. That the creditors are divided into classes, those whose claims have to be paid in priority to other creditors being separately shown.

The method of preparing a Statement of Affairs may perhaps best be illustrated by setting out the position of a trader in the form of a Balance Sheet and of a Statement of Affairs respectively:—

BALANCE SHEET OF WM. BROWN AT 31 DECEMBER, 1913

Liabilities	£	s.	d.	*Assets*	£	s.	d.
SUNDRY CREDITORS, VIZ.:				Cash in hand	7	8	3
On Open Accounts £2478 10 6				SUNDRY DEBTORS, VIZ.:			
" Bills Payable 1516 4 2				On Bills Receivable £250 0 0			
	3994	14	8	" Open Accounts 1968 10 0			
Bank Overdraft	943	7	8		2218	10	0
Outstanding Creditors for Rent, &c.	94	6	0	Business Premises (subject to mortgage)	2000	0	0
				CAPITAL ACCOUNT:			
				Drawings £300 0 0			
				Loss on Trading as per Profit and Loss Account 1506 10 1			
				£1806 10 1			
				Less Capital on 1 January, 1913 1000 0 0			
					806	10	1
	5032	8	4		5032	8	4

NOTE.—Brown had discounted bills for £500 on which he is contingently liable as indorser.

This position would be stated in Statement of Affairs form as shown on p. 222.

Comparison of Balance Sheet and Statement of Affairs

It will be observed that in the Statement of Affairs there are two cash columns on the liabilities side, one for the gross amounts of the liabilities of all kinds, and the other for sums which are expected to result in claims against the free assets in any distribution to creditors. This arrangement brings out clearly one of the chief objects of the statement, viz. that it shall show creditors what amount is expected to be available to meet their claims after making provision for creditors who hold security by way of charges on the assets, and for those creditors to whom the Bankruptcy Acts give priority of payment. The gross liabilities in the statement exceed those in the balance sheet by £500 by reason of the contingent liability on discounted bills being included at the full amount.

Dealing with the items, the bank overdraft ranks as a fully secured claim by reason of a mortgage of the premises having been given to the bank as security. As the premises are estimated to be worth £1500, while the overdraft is only £943, 7*s.* 8*d.*, the bank is fully secured and will not rank against the free assets in competition with the other creditors. If the premises had been valued at anything less than the amount of the overdraft the bank would have been shown as a partly secured creditor, and the difference between the amount of the

STATEMENT OF AFFAIRS OF WILLIAM BROWN AS AT 31 DECEMBER, 1913

Gross Liabilities.			Liabilities.				Expected to Rank.			Assets.			
£	s.	d.					£	s.	d.			£	s.	d.
3994	14	8	Unsecured Creditors				3994	14	8	PROPERTY, VIZ.:				
943	7	8	Fully Secured Creditors	£943	7	8				Cash at Bankers				
			Estimated Value of Security, viz. Mortgage on Business Premises	1500	0	0				Cash on hand		7	8	3
										Stock-in-trade (cost £)				
										Machinery				
										Trade Fixtures, &c.				
			Estimated Surplus to *contra*	£556	12	4				Other Property, viz.				
												7	8	3
			Partly Secured Creditors	:	:					BOOK DEBTS, VIZ.:				
			Estimated Value of Security	:	:					Good		872	15	0
										Doubtful	£1000 0 0			
										Bad	95 15 0			
											£1095 15 0			
			Balance Estimated to rank for Dividend											
			Liabilities on Bills discounted other than the Debtor's own Acceptances, viz.:							Estimated to produce		250	0	0
										Bills of Exchange on hand available as Assets		250	0	0
			On Accommodation Bills	:	:					Surplus from Security in the hands of Fully Secured Creditors		556	12	4
			" other Bills as Indorser or											
500	0	0	Drawer	£500	0	0						1936	15	7
										Deduct Creditors for Rent, Rates, Taxes, &c., per *contra*		94	6	0
			Of which it is expected will rank for Dividend				100	0	0	Amount available to meet Unsecured Creditors		1842	9	7
			Contingent Liabilities							Deficiency explained in Deficiency Account		2252	5	1
			Creditors for Rent, Rates, Taxes, &c.											
			Wages payable in full:											
94	6	0	Deducted *contra*	£94	6	0								
5532	8	4					4094	14	8			4094	14	8

overdraft and the value of the premises would have been entered in the "Estimated to Rank" column as representing the unsecured portion of the bank's claim.

The liability of £500 on Bills of Exchange is the face value of bills of which the debtor is not the acceptor, but which have come to him in ordinary course of business and which he has discounted. As he has endorsed them he is liable upon them in the event of dishonour by the acceptor. It is anticipated that the acceptor of one of the bills for £100 will fail to pay. This will result in a claim on the debtor, and the amount is accordingly entered in the "Estimated to Rank" column. If the debtor were a party to any accommodation bills they would be entered here.

The heading of "Contingent Liabilities" is provided for such items as guarantees and calls on partly paid shares which may result in claims against the assets.

Rent recoverable by distress, rates, taxes, wages, and salaries are, subject to certain conditions, entitled to priority of payment out of the assets not specifically charged to secured creditors. They are not, therefore, shown in the "Estimated to Rank" column, but are deducted in full from the total of the free assets.

Of the assets shown in the Balance Sheet, the premises have been dealt with under the head of Fully Secured Creditors, being valued at £1500 as against £2000 in the Balance Sheet. The other assets are summarized under their appropriate headings, and are valued at the amounts they are estimated to produce on immediate realization. The surplus estimated to result from the sale of the premises after satisfying the bank overdraft is included as being available for the other creditors.

From the total of the assets the preferential creditors are deducted, leaving an amount available for the ordinary unsecured creditors. The difference between this amount and the unsecured claims is the amount of the deficiency of assets to meet liabilities.

The reason why this deficiency has arisen has to be explained in a "Deficiency Account" which is attached to the Statement of Affairs. Let it be

assumed that Brown started in business on 1 January, 1913, with a capital of £1000. The Deficiency Account compiled upon the basis of the above figures would appear as follows:—

DEFICIENCY ACCOUNT

	£	s.	d.		£	s.	d.
Excess of Assets over Liabilities on 1 January, 1913 (i.e. Capital)	1000	0	0	Excess of Liabilities over Assets on 1 January, 1913			
Net Profit (if any) arising from carrying on business				Net Loss (if any) arising from carrying on business as per Balance Sheet	1506	10	1
Income or Profit from other sources				Bad Debts (i.e. £1095, 15s., *less* £250)	845	15	0
Deficiency as per Statement of Affairs	2252	5	1	Expenses incurred since 1 January, 1913, other than trade expenses, viz. household expenses (Drawings)	300	0	0
				OTHER LOSSES AND EXPENSES, VIZ.:			
				On realization of Premises	500	0	0
				„ Bill of Exchange	100	0	0
	3252	5	1		3252	5	1

Basis of the Statement of Affairs

The basis of the Statement of Affairs and Deficiency Account is the same as that of a Balance Sheet and Profit and Loss Account, viz. the Trial Balance. It is just as necessary to extract a Trial Balance from the books before preparing a Statement of Affairs as it is when making up a Balance Sheet. There is no reasonable hope of effecting an agreement between the two sides of either document until the books have first been found to balance. It is of material assistance in preparing a Statement of Affairs to draw up a Balance Sheet and a Profit and Loss Account in the usual way and then to transfer the items to the Statement of Affairs forms. By this means it can be ensured that every item in the books is brought into the statement, and the fact that the preparation of a Balance Sheet is much more familiar than a Statement of Affairs will conduce to the minimizing of the risk of errors.

COMPANIES' LIQUIDATION

In the case of the liquidation of a company it is only necessary to lodge a Statement of Affairs in those cases where an order to wind up the company has been made by the Court; but it is very desirable to have a Statement in the same form in all company liquidations. In compulsory cases the statement with regard to the assets and liabilities of the company is prepared in the same way as in bankruptcy, except that there is an additional item on the assets side for the estimated realizable value of any unpaid calls on shares, and an additional item on the liabilities side for debenture holders whose claims are deducted in full from the assets in the same way as preferential creditors. There is also an additional section to the statement relating to the share capital, which is stated in the manner shown on p. 224.

REALIZATION AND DISTRIBUTION

The methods of appointment of trustees and liquidators are dealt with in Part III, Chapters XI and IV. As soon as the appointment is completed the trustee or liquidator proceeds to realize the assets. The only account which it is strictly necessary for him to keep is a Cash Account showing his receipts and payments, but it is desirable to open accounts for the various assets shown in the Statement of Affairs and for his several heads of expenses, as this will facilitate the preparation of the final statement which has to be sent to creditors. A periodical survey of the accounts will also ensure that the realization of all the assets receives constant attention.

Distribution

If it is possible to realize all the property speedily

II.—AS REGARDS CONTRIBUTORIES

	£	s.	d.	£	s.	d.		£	s.	d.
Capital Issued and Allotted, viz.:										
10,000 Ordinary Shares of £1 per share:										
Issued as fully paid	5,000	0	0							
Called up at £1 per share on 5000 shares	5,000	0	0							
5000 Preference Shares of £1 per share:										
Issued as fully paid										
Called up at £1 per share on 5000 shares	5,000	0	0							
	15,000	0	0							
Less Unpaid Calls estimated to be irrecoverable	100	0	0							
				14,900	0	0				
Add Deficiency to meet Liabilities as above (i.e. Part I as regards creditors), say				3,400	0	0				
				18,300	0	0	Estimated Surplus as above (i.e. Part I as regards creditors), subject to costs of liquidation	18,300	0	0
							Total Deficiency as explained in Deficiency Account			
								18,300	0	0

it is the duty of the trustee or liquidator to pay the expenses and distribute the amount available amongst the creditors at once. Before this can be done it is, of course, necessary to ascertain who are the creditors and what are the correct amounts of their respective claims. In cases of bankruptcy and compulsory liquidations the lists of creditors in the Statement of Affairs form the basis of the distribution. In other cases lists are prepared from the books and documents which have come into the possession of the trustee or liquidator, and notice is sent to any creditors who have not lodged their claims that they must do so by a certain date or they will be excluded from the distribution. Advertisements are also inserted in the Press calling upon creditors to lodge their claims, or to "prove" as it is termed. It is the duty of the trustee or liquidator to examine the claims and to admit or reject them as he thinks fit as the result of his examination. Any creditor who is not satisfied with the decision may appeal to the Court to vary it.

When the list of creditors entitled to participate in the distribution has been settled, the trustee calculates the amount to which each is entitled out of the amount available and makes the distribution accordingly. All debts entitled to priority of payment before the ordinary creditors must first be paid in full before calculating the amount divisible amongst the ordinary creditors.

Returns to Contributories

In the case of company liquidations it sometimes happens that there is a surplus after paying the expenses and the creditors' claims. In such cases it is necessary to make a return of capital to the shareholders. The basis upon which this return is made depends largely upon the company's Articles of Association, particularly when there is more than one class of share. Preference shareholders usually, but not always, have the right to have their capital returned in full before ordinary shareholders receive anything, and when this is the case any surplus must be paid to them. Further, if there should be any ordinary capital not called up or paid up the liquidator must proceed to get it in if it is required for the purpose of paying the preference shareholders in full. If necessary the liquidator must make a call, and he must also do so if some of the ordinary shares have had more called up on them than others. This is done in order to adjust the rights of the shareholders *inter se*, the principle being that every shareholder in a particular class should lose the same amount per share. This position is best explained by means of an example:—

X. Y. Z., Ltd., went into liquidation, and the assets realized £4681.

The expenses of the liquidation were £678.
The preferential creditors amounted to £126.
Ordinary creditors amounted to £1037.

The share capital was:—
3000 Preference shares of £1 each, fully paid;
5000 Ordinary shares of £1 each, fully paid;
2000 Ordinary shares of £1 each, 10s. paid.

The preference shares were preferential as to both capital and dividends.

As the assets were not sufficient to enable the preference capital to be returned in full, the liquidator made a call of 10s. per share upon the 2000 ordinary shares and the call was paid up in full. The following account shows how the distribution was effected:—

X. Y. Z., Ltd.—SUMMARY OF LIQUIDATOR'S RECEIPTS AND PAYMENTS

	£	s.	d.		£	s.	d.
To Proceeds of Assets	4681	0	0	By Expenses of Liquidation	678	0	0
				" Preferential Creditors	126	0	0
				" Ordinary Creditors	1037	0	0
				" Balance c/d	2840	0	0
	4681	0	0		4681	0	0
To Balance b/d	2840	0	0	By Return of £1 per share to Preference Shareholders	3000	0	0
" Proceeds of Call of 10s. per share on 2000 Ordinary Shares	1000	0	0	" Return of 2s. 4¼d. per share on 7000 Ordinary Shares	840	0	0
	3840	0	0		3840	0	0

It was not really necessary to call up the whole of the 10s. per share uncalled on the 2000 ordinary shares, since a return of capital is made on them; but having regard to the fact that the amount not called would have been very small, and that some of the shareholders might have failed to pay, it would not have been advisable to call less than 10s. per share.

Accounts of Trustees and Liquidators

The Bankruptcy and Companies Acts provide that trustees, both in bankruptcies and under Deeds of Arrangements, and liquidators in compulsory and voluntary liquidations shall render accounts to the Board of Trade periodically in prescribed forms. It is not necessary to deal with these accounts in detail, and it will suffice to say that they take the form of summaries of receipts and payments and are on a purely cash basis. It is also necessary for trustees and liquidators to keep accounts of their trading if the business of the debtor or the company is carried on, and to account to the Board of Trade in a prescribed form in respect of the trading.

When the estate has been fully realized and the proceeds distributed the trustee or liquidator, as the case may be, is required to forward to each creditor (and shareholder in the case of a company) a statement showing the result of the bankruptcy or liquidation. These statements are in prescribed forms, and that applicable to a company in compulsory liquidation is shown on p. 226.

RECONSTRUCTION OF COMPANIES

The reconstruction of most companies takes place in consequence of their non-success. It is usually effected by the winding up of the company and the sale of its assets to a new company—generally with the same or a similar name. The scheme provides as a rule that the shareholders of the old company shall be entitled to shares in the new company in a stated proportion to their holding in the old company, and frequently this is on condition that the shares they receive in the new company shall be treated as partly and not as fully paid up. This is often the case in such undertakings as mining companies which have issued all their capital and whose shares are fully paid. The property may not have reached a paying stage, a further issue of capital is not practicable, and the only means by which more money can be raised to proceed with the development is by getting it from the existing shareholders, who will lose what they have already invested unless they agree to find the

STATEMENT SHOWING POSITION OF COMPANY AT DATE OF LIQUIDATOR'S APPLICATION FOR RELEASE

Dr. *Cr.*

	Estimated to produce per Company's Statement. £	s.	d.	Receipts. £	s.	d.		£	s.	d.	Payments. £	s.	d.
To Total Receipts from Date of Winding-up Order, viz.:							By Board of Trade and Court Fees, viz.:						
(State particulars under the several headings specified in the Statement of Affairs.)							Fees in respect of Contributories, Creditors, and Debtors (including Printing, Postages, and Stationery)	33	0	0			
Cash in hand	0	15	2	0	15	2	Percentage on £5681 Assets realized	284	1	0			
Cash at Bank	3	5	1	3	5	1	Percentage on £5003 Assets distributed	125	1	6			
Patents	5000	0	0	1500	0	0	Audit Fee	56	16	0			
Leasehold Premises and Machinery	3000	0	0	2000	0	0	Court Fees, including £2 Stamp on Petition	15	6	0			
Stock	500	0	0	300	0	0					514	4	6
Debtors	1121	4	3	876	19	9	Law Costs of Petition, after deducting £2 Stamp on Petition	31	6	8			
Amounts received from Calls on Contributories made by the Liquidator				1000	0	0	Law Costs of Solicitor to Liquidator	62	9	0			
Receipts per Trading Account							Other Law Costs				93	15	8
Other Receipts							Shorthand Writer's Charges						
							Special Manager's Charges						
							Person appointed to assist in preparation of Statement of Affairs				15	15	0
							Auctioneer's and Valuer's Charges as taxed				43	2	6
							Other Taxed Costs						
							Costs of Possession and Maintenance of Estate				3	4	8
							Costs of notices in Gazette and Local Papers				3	15	0
							Incidental outlay				4	2	8
Total	9625	4	6	5681	0	0	Total costs and charges				678	0	0
Less:	£	s.	d.				Creditors, viz.:	£	s.	d.			
Payments to redeem Securities							5 Preferential	126	0	0			
Costs of Execution							48 Unsecured	1037	0	0			
Payments per Trading Account							1st and final dividend of 20s. in the £ on £1037.						
							The estimate of amount expected to rank for Dividend was £946, 18s.						
Net realizations				5681	0	0	Amount returned to Contributories on 3000 Preference Shares at 20s. per share	3000	0	0			
							And on 7000 Ordinary Shares at 2s. 4½d. per share	840	0	0			
											5003	0	0
				5681	0	0					5681	0	0

money and come into the reconstruction. Shareholders have, of course, the right to dissent and to receive the value of their shares in the old company, but this is usually very little.

The procedure adopted is described in Part III, Chapter IV.

The entries in the books of the two companies to record the sale and purchase of an undertaking in consequence of a reconstruction will best be understood by means of an example, but it may be stated generally that the entries relating to the sale are very similar to those made on the winding up of a partnership, whilst those made in the books of the new company in relation to the purchase of the property do not differ substantially from those made in connection with the purchase of a business from an individual.

The following is the—

BALANCE SHEET OF THE X. GOLD MINING COMPANY, LTD., AT 1 DECEMBER, 1913

Capital and Liabilities	£	s.	d.	*Assets*	£	s.	d.
Sundry Creditors	2,650	0	0	Property	85,000	0	0
SHARE CAPITAL:				Development Account	26,000	0	0
120,000 shares of £1 each, fully paid	120,000	0	0	Machinery and Plant	5,000	0	0
				Profit and Loss Account	6,650	0	0
	122,650	0	0		122,650	0	0

The directors laid a scheme of reconstruction before the shareholders which provided that the company should go into voluntary liquidation and that a new company should be formed to take over the assets at the price of £80,000, to be paid by the issue to the shareholders of five shares of £1 each in the new company, treated as being 16s. per share paid up for every six fully paid shares in the old company; the new company to undertake to pay the liabilities of the old company and the expenses of the liquidation. The scheme was approved, and all the shares in the new company were taken up by the shareholders. The agreement was duly carried out, the expenses amounting to £500. The entries in the books of the two companies were as follows:—

JOURNAL OF OLD COMPANY

1913.				£	s.	d.	£	s.	d.
Dec.	31	REALIZATION ACCOUNT	*Dr.*	116,000	0	0			
		To Property					85,000	0	0
		" Development Account					26,000	0	0
		" Machinery					5,000	0	0
		To transfer book value of assets.							
	"	NEW COMPANY	*Dr.*	83,150	0	0			
		To Realization Account					83,150	0	0
		For amount payable by new company in respect of assets, liabilities, and expenses.							
	"	REALIZATION ACCOUNT	*Dr.*	500	0	0			
		To Liquidation Expenses					500	0	0
		For cost of winding up old company.							
	"	CREDITORS	*Dr.*	2,650	0	0			
	"	LIQUIDATION EXPENSES	"	500	0	0			
		To New Company					3,150	0	0
		For amount of liabilities assumed.							
	"	PROFIT AND LOSS ACCOUNT	*Dr.*	33,350	0	0			
		To Realization Account					33,350	0	0
		To transfer loss on sale of assets.							
	"	SHARE CAPITAL ACCOUNT	*Dr.*	40,000	0	0			
		To Profit and Loss Account					40,000	0	0
		To transfer loss to shareholders.							
	"	SHARE CAPITAL ACCOUNT	*Dr.*	80,000	0	0			
		To New Company					80,000	0	0
		For value of shares in new company issued to shareholders in old company.							

LEDGER OF OLD COMPANY

Realization Account

1913.			£	s.	d.	1913.			£	s.	d.
Dec.	31	To Property	85,000	0	0	Dec.	31	By New Company	83,150	0	0
	"	" Development	26,000	0	0		"	" Profit and Loss Account	33,350	0	0
	"	" Machinery	5,000	0	0						
	"	" Liquidation Expenses	500	0	0						
			116,500	0	0				116,500	0	0

New Company

1913.			£	s	d.	1913.			£	s.	d.
Dec.	31	To Realization Account	83,150	0	0	Dec.	31	By Liability to Creditors taken over	2,650	0	0
							"	" Liquidation Expenses	500	0	0
							"	" Share Capital Account	80,000	0	0
			83,150	0	0				83,150	0	0

Profit and Loss Account

1913.			£	s.	d.	1913.			£	s.	d.
Dec.	31	To Balance	6,650	0	0	Dec.	31	By Share Capital Account	40,000	0	0
	"	" Realization Account	33,350	0	0						
			40,000	0	0				40,000	0	0

Share Capital

1913.			£	s.	d.	1913.			£	s.	d.
Dec.	31	To Transfer from Profit and Loss	40,000	0	0	Dec.	31	By Balance	120,000	0	0
	"	" New Company	80,000	0	0						
			120,000	0	0				120,000	0	0

Liquidation Expenses

1913.			£	s.	d.	1913.			£	s.	d.
Dec.	31	To New Company	500	0	0	Dec.	31	By Realization Account	500	0	0

The Property, Development, and Machinery accounts will be closed by transfers to the Realization Account, and the various creditors' accounts may be closed by transfers to the new company's account.

JOURNAL OF NEW COMPANY

1914.				£	s.	d.	£	s.	d.
Jan.	1	PROPERTY	*Dr.*	75,000	0	0			
	"	MACHINERY...	"	5,000	0	0			
		To Share Capital Account					80,000	0	0
		For the amount credited as paid up on 100,000 shares of £1 each (16*s.* paid), issued in payment for property and machinery acquired.							
	"	CASH	*Dr.*	20,000	0	0			
		To Share Capital					20,000	0	0
		For the amount received on 100,000 shares at 4*s.* per share.							
	"	PROPERTY ACCOUNT	*Dr.*	2,650	0	0			
		To Cash...					2,650	0	0
		For the amount paid to creditors of old company.							
	"	PRELIMINARY EXPENSES	*Dr.*	500	0	0			
		To Cash...					500	0	0
		Being the amount of the liquidation expenses of the old company.							

LEDGER OF NEW COMPANY

SHARE CAPITAL ACCOUNT

			£	s.	d.
1914.					
Jan.	1	By Property	75,000	0	0
	"	" Machinery	5,000	0	0
	"	" Cash.....	20,000	0	0

PROPERTY

1914.			£	s.	d.
Jan.	1	To Share Capital.....	75,000	0	0
	"	" Cash (amount paid to old company's creditors)..	2,650	0	0

MACHINERY

1914.			£	s.	d.
Jan.	1	To Share Capital.....	5,000	0	0

PRELIMINARY EXPENSES

1914.			£	s.	d.
Jan.	1	To Cash.....	500	0	0

The following would be the Balance Sheet of the new company immediately after making the above entries:—

BALANCE SHEET OF THE NEW X. GOLD MINING COMPANY. LTD.

	£	s.	d.		£	s.	d.
To Share Capital.....	100,000	0	0	By Property.....	77,650	0	0
				" Machinery.....	5,000	0	0
				" Preliminary Expenses.....	500	0	0
				" Cash.....	16,850	0	0
	100,000	0	0		100,000	0	0

The cash shown in the Balance Sheet is the £20,000 received on 100,000 shares at 4s. per share, less the amount paid to creditors, £2650, and the liquidation expenses, £500.

Effect of Book Entries

The general effect of these entries in the books of the old company is to transfer to the Profit and Loss Account the loss on the sale of the property. The tangible assets consisting of the cost of the property, plus the cost of development and the machinery, stood in the Balance Sheet at £116,000. Against this there was a sum of £2650 due to creditors, leaving the net assets £113,350. As the new company is to pay to the old company or its liquidator £80,000 for the property, there is a loss of £33,350, which is written off to the Profit and Loss Account. That account already has an amount of £6650 standing to its debit in respect of the accumulated loss on trading, so that the total debit is £40,000, which represents the total loss to the shareholders in the old company. This loss is transferred to the Capital Account and reduces the balance on that account to £80,000, the value of the shareholders' interest in the undertaking and the amount which they will receive in partly paid shares in the new company.

The real cost of the property to the new company is £82,650, since it not only pays the old company £80,000 in shares, but also discharges its liabilities to creditors. The liquidation expenses of the old company, which are also paid, might be treated as part of the cost, but the better course is to treat them as preliminary expenses. The cost of registration of the new company and any other expenses incurred in its formation would also be debited to the Preliminary Expenses Account. The Share Capital Account of the new company is credited with the amount treated as having been paid up on the 100,000 shares issued in payment of the purchase price, i.e. £80,000. The balance of £20,000 received in cash is dealt with in the same way as cash received on the original issue of capital. Accounts are opened and debited with the amounts payable on application, allotment, &c., by the shareholders, and credited to the Share Capital Account. As the cash comes in it is entered on the debit side of the Cash Book and posted to the credit of the respective accounts. The net result of the entries is a debit to cash and a credit to share capital, and for the sake of clearness the transaction is shown in this way in the above journal entries.

So far as the shareholders are concerned the position is that they retain their interest in the property, but the £1 shares which they hold in the new company represent an outlay of £1, 8s. per share. This is because they have received only five shares in the new company for every six £1 shares in the old company, and have paid in addition 4s. per share on the new shares.

Amalgamations

The amalgamation of two or more companies in one undertaking may be effected for one or more of many reasons. The companies may be prosperous or the reverse. An instance has been given of reconstruction in consequence of non-success, and an example will now be taken for purpose of illustration of an amalgamation of two flourishing undertakings. An important factor to be determined before the amalgamation can take place is the value to be placed on the various assets of the two concerns. In the example given it is assumed that the values stated in the Balance Sheets are agreed between the two companies. If any of the assets appeared at more or less than their real values it would be necessary to prepare an amended Balance Sheet showing the agreed figures, in order to arrive at the basis on which the amalgamation shall take place.

The Balance Sheets shown below give the position of two companies, one of which was a manufacturing business and the other that of a

wholesale house dealing in the commodity which was manufactured by the first. They agreed to amalgamate as from the date of the Balance Sheets.

BALANCE SHEET OF GAMMA & CO., LTD., ON 31 DECEMBER, 1913

	£	s.	d.		£	s.	d.
To Share Capital	40,000	0	0	By Freehold Property and Fittings	15,000	0	0
" Creditors	7,000	0	0	" Machinery and Plant	25,000	0	0
" Profit and Loss—Balance	10,000	0	0	" Stock and Materials	9,000	0	0
				" Debtors	5,000	0	0
				" Cash	3,000	0	0
	57,000	0	0		57,000	0	0

BALANCE SHEET OF DELTA & CO., LTD., ON 31 DECEMBER, 1913

	£	s.	d.		£	s.	d.
To Share Capital	20,000	0	0	By Leasehold Premises and Fittings	14,000	0	0
" Creditors	5,000	0	0	" Stock	12,000	0	0
" Reserve Fund	6,000	0	0	" Debtors	4,500	0	0
" Profit and Loss—Balance	4,000	0	0	" Cash	4,500	0	0
	35,000	0	0		35,000	0	0

The amalgamation takes the form of a sale to a new company which is registered under the title of Gamma, Delta, and Co., Ltd., and which takes over the assets and discharges the liabilities as from 1 January, 1914. The price is fixed at the net value of the assets of the two undertakings and is arrived at as follows:—

GAMMA & CO., LTD.:		
Assets per Balance Sheet	£57,000	
Less Liabilities	7,000	
		50,000
DELTA & CO., LTD.:		
Assets per Balance Sheet	£35,000	
Less Liabilities	5,000	
		£30,000
Total Net Assets (and purchase price)		£80,000

This price is satisfied by the new company issuing 80,000 fully paid £1 shares to the shareholders of the two companies, the shareholders in Gamma & Co. receiving 50,000 and those in Delta & Co. 30,000 shares. The shareholders in the former company, therefore, receive five shares in the new company for every four held by them in Gamma & Co., whilst the shareholders in Delta & Co. receive three shares for every two. This represents their real interests in the respective companies, since in the former case, in addition to the £40,000 capital, there were undistributed profits amounting to £10,000 in the form of the balance of the Profit and Loss Account, and in the latter the undivided profits were also £10,000 (including the Reserve Fund) in addition to £20,000 capital.

The entries in the books of the two companies to record the sale of the undertakings will be similar to those already shown in the case of a reconstruction, except that instead of a loss being transferred to the Share Capital Accounts there is a profit in each case of £10,000. The entries in the books of the new company would follow those of a company taking over a business in ordinary course, which have been shown previously and need not therefore be detailed. In order to keep the example free from complications no mention has hitherto been made of the expenses consequent on the winding up of the two old companies and the formation of the new company. These would be paid by the latter, and assuming that they amounted to £1000 the Balance Sheet of the new company would appear as follows:—

BALANCE SHEET OF GAMMA, DELTA, & CO., LTD., ON 1 JANUARY, 1914

	£	s.	d.		£	s.	d.
To Share Capital	80,000	0	0	By Freehold and Leasehold Premises and Fittings	29,000	0	0
" Creditors	12,000	0	0	" Machinery and Plant	25,000	0	0
				" Stock and Materials	21,000	0	0
				" Debtors	9,500	0	0
				" Cash	6,500	0	0
				" Preliminary Expenses	1,000	0	0
	92,000	0	0		92,000	0	0